15 AAC 55.192 is amended to read:

15 AAC 55.192. Monthly share of annual transportation costs. (a) For purposes of AS 43.55.160(c), a producer shall determine the appropriate monthly share of the producer's costs of transportation for a calendar year using an acceptable method under this section that the producer chooses for this purpose and applying that method consistently for all months of the calendar year. An acceptable method is

(1) a method that the producer used consistently in calculating its tax under AS 43.55 during calendar year 2005;

(2) any of the following methods as applicable:

(A) for transportation described in [15 AAC 55.191(b)(1), (2), (4)(A), OR (5) OR] 15 AAC 55.193(b)(1), (2), (4)(A), or (5),

(i) use of the actual or reasonable costs of transportation, as applicable, of the oil and gas produced or shipped during the month in question and that are allowable under the applicable provision of [15 AAC 55.191 OR] 15 AAC 55.193; or

(ii) use of the per barrel, per Mcf, or per MMBTU annual average of the actual or reasonable costs of transportation, as applicable, for the oil or gas produced or shipped during the calendar year and that are allowable under the applicable provision of [15 AAC 55.191 OR] 15 AAC 55.193;

(B) for transportation described in [15 AAC 55.191(b)(3), (4)(B), OR (8) OR] 15 AAC 55.193(b)(3), (4)(B), or (6), use of the per barrel, per Mcf, or per MMBTU annual average of the actual or reasonable costs of transportation, as applicable, of the oil

or gas produced or shipped during the calendar year and that are allowable under the applicable provision of [15 AAC 55.191 OR] 15 AAC 55.193; or

(3) another method that is approved by the department as fairly representing the appropriate monthly share of the producer's transportation costs for a calendar year.

(b) A producer may not shift transportation costs between months for the purpose of reducing a tax levied by AS 43.55.011(g), as that provision read on June 30, 2007, or a tax levied by AS 43.55.011(e). (Eff. 5/3/2007, Register 182; am 4/30/2010, Register 194; am _____/_____/_____, Register _____)

Authority: AS 43.05.080 AS 43.150 AS 43.55.160
AS 43.55.110

15 AAC 55.193(b)(3) is amended to read:

(3) if transportation of oil is by a vessel that is owned or effectively owned, in whole or in part, by the producer of that oil, the sum of

(A) voyage and port costs incurred with respect to that transportation, as provided in (e) of this section;

(B) the positioning cost, amortized over 36 months, for that vessel; **and**

(C) **depreciation of the vessel and a cost of capital allowance calculated under 15 AAC 55.196(d);** [DEPRECIATION OF THE VESSEL AS CALCULATED BY THE PRODUCER FOR FINANCIAL ACCOUNTING PURPOSES AND USED FOR REPORTING INCOME AND EXPENSES TO SHAREHOLDERS AND OWNERS, OR AS PROVIDED IN 15 AAC 55.195(a), (b), OR (c) OR 15 AAC 55.196, AS APPLICABLE; AND]

(D) repealed _____/_____/_____. [AN AMOUNT THAT, WHEN ADDED TO THE AMOUNT OF DEPRECIATION ALLOWED UNDER (C) OF THIS PARAGRAPH, WILL PROVIDE A REASONABLE AFTER-TAX RETURN ON THE ACQUISITION COST, AS PROVIDED IN 15 AAC 55.195(a), OF THE VESSEL OVER ITS EXPECTED USEFUL LIFE AS USED FOR FINANCIAL ACCOUNTING PURPOSES AND USED FOR REPORTING INCOME AND EXPENSES TO SHAREHOLDERS AND OWNERS, OR ON THE ADJUSTED SHIPYARD COST OR INVESTED CAPITAL AS PROVIDED IN 15 AAC 55.195(b) OR (c) OR 15 AAC 55.196, AS APPLICABLE;]

15 AAC 55.193(b)(4) is amended to read:

(4) in the case of transportation of gas as liquefied natural gas (LNG) by an LNG transportation facility not subject to tariff regulations of the Federal Energy Regulatory Commission or another federal agency, a state, territory, or possession of the United States, or a foreign nation,

(A) if the producer does not own or effectively own, in whole or in part, the LNG transportation facility, the amount charged to the producer for that LNG transportation;

(B) if the producer owns or effectively owns, in whole or in part, the LNG transportation facility, the sum of

(i) the direct operating costs of the LNG transportation facility incurred with respect to the producer's gas; for an LNG tanker, direct operating

costs consist of the tanker's voyage and port costs as provided in (d) of this section;

(ii) the positioning cost, amortized over 36 months, in the case of an LNG tanker; **and**

(iii) **depreciation of the LNG transportation facility and a cost of capital allowance calculated under 15 AAC 55.196(d);** [DEPRECIATION OF THE LNG TRANSPORTATION FACILITY AS CALCULATED BY THE PRODUCER FOR FINANCIAL ACCOUNTING PURPOSES AND USED FOR REPORTING INCOME AND EXPENSES TO SHAREHOLDERS AND OWNERS, OR AS PROVIDED IN 15 AAC 55.195(a), (b), (c), OR (d) OR 15 AAC 55.196, AS APPLICABLE;]

(iv) repealed _____/_____/_____ [AN AMOUNT THAT, WHEN ADDED TO THE AMOUNT OF DEPRECIATION ALLOWED UNDER (III) OF THIS SUBPARAGRAPH, WILL PROVIDE A REASONABLE AFTER-TAX RETURN ON THE ACQUISITION COST, AS PROVIDED IN 15 AAC 55.195(A), (B), (C), OR (D), AS APPLICABLE, OF THE LNG TRANSPORTATION FACILITY OVER ITS EXPECTED USEFUL LIFE AS USED FOR FINANCIAL ACCOUNTING PURPOSES AND USED FOR REPORTING INCOME AND EXPENSES TO SHAREHOLDERS AND OWNERS, OR ON THE ADJUSTED SHIPYARD COST OR INVESTED CAPITAL AS PROVIDED IN 15 AAC 55.195(a), (b), (c), OR (d) OR 15 AAC 55.196, AS APPLICABLE];

(Eff. 4/30/2010, Register 194; am 3/1/2017, Register 221, am _____/_____/_____, Register _____)

Authority: AS 43.05.080 AS 43.55.040 AS 43.55.150
AS 43.55.020 AS 43.55.110 AS 43.55.900
AS 43.55.030

15 AAC 55.195 is repealed.

15 AAC 55.195. Return on investment or cost of capital allowance to be used in calculation of costs of transportation for oil or gas, other than certain LNG or vessel transportation costs for oil or gas produced on or after January 1, 2003 Repealed. [(a) FOR A VESSEL, LNG TRANSPORTATION FACILITY, OR CAPITALIZED IMPROVEMENT PLACED IN SERVICE BEFORE JANUARY 1, 1995, BY THE PRODUCER OR BY A PERSON FROM WHOM, DIRECTLY OR THROUGH AN INTERMEDIATE TRANSACTION OF THE SAME NATURE, THE PRODUCER LATER ACQUIRED THE VESSEL AS PART OF A LARGER TRANSFER OF BOTH MARINE AND NON-MARINE ASSETS ASSOCIATED WITH A BUSINESS MERGER OR ACQUISITION TRANSACTION, A REASONABLE RETURN INCLUDING DEPRECIATION UNDER 15 AAC 55.191(b)(3)(C) AND (D), 15 AAC 55.191(b)(4)(B)(III) AND (IV), 15 AAC 55.193(b)(3)(C) AND (D), OR 15 AAC 55.193(b)(4)(B)(III) AND (IV) IS AN AMOUNT THAT YIELDS A RETURN ON THE ACQUISITION COST OF THE VESSEL, LNG TRANSPORTATION FACILITY, OR CAPITALIZED IMPROVEMENT, AFTER FEDERAL INCOME TAX, OF TWO PERCENT PLUS THE AVERAGE ANNUAL NATIONAL INFLATION RATE, MEASURED BY THE COMPOUND ROOT OF THE GNP DEFLATOR,

DURING THE PERIOD BETWEEN THE TIME THE COMMITMENT WAS MADE TO CONSTRUCT OR INITIALLY ACQUIRE THE VESSEL, LNG TRANSPORTATION FACILITY, OR CAPITALIZED IMPROVEMENT FOR THE PURPOSE OF PLACING IT IN SERVICE AND THE TIME WHEN THE VESSEL, LNG TRANSPORTATION FACILITY, OR CAPITALIZED IMPROVEMENT HAD BEEN RECEIVED OR DELIVERED AND WAS READY TO BE PLACED INTO SERVICE, OR IF THAT PERIOD FELL ENTIRELY WITHIN A CALENDAR YEAR, DURING THAT ENTIRE CALENDAR YEAR, EXCEPT THAT IF THE DEPARTMENT REPLACED THAT RATE OF RETURN WITH A DIFFERENT RATE OF RETURN FOR A VESSEL, LNG TRANSPORTATION FACILITY, OR CAPITALIZED IMPROVEMENT UNDER FORMER 15 AAC 55.190(i), THAT DIFFERENT RATE OF RETURN IS ALLOWED INSTEAD. THE ALLOWANCE FOR THE REASONABLE RETURN ON THE ACQUISITION COST IS A LEVEL ANNUAL AMOUNT, DETERMINED IN THE YEAR OF INITIAL ACQUISITION FOR THE PURPOSE OF PLACEMENT IN SERVICE, CONSIDERING THE MARGINAL FEDERAL CORPORATE INCOME TAX RATE IN EFFECT THAT YEAR AND THE CONTEMPORANEOUS AND PROJECTED FEDERAL INCOME TAX BENEFITS. IF, IN SUBSEQUENT YEARS, THE FEDERAL TAX RATE CHANGES, OR OTHER EVENTS OCCUR THAT CHANGE THE AVAILABLE FEDERAL INCOME TAX BENEFITS, A REVISED LEVEL ANNUAL ALLOWANCE MUST BE CALCULATED TO YIELD THE SAME AFTER-TAX RETURN. FOR PURPOSES OF THIS SUBSECTION,

(1) "ACQUISITION COST" MEANS THE AMOUNT, NOT TO EXCEED THE COST OF THE VESSEL, LNG TRANSPORTATION FACILITY, OR CAPITALIZED IMPROVEMENT WHEN INITIALLY ACQUIRED FOR THE PURPOSE OF PLACING IT IN

SERVICE, CAPITALIZED BY THE ITEM'S ACTUAL OR EFFECTIVE OWNER UNDER GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, INCLUDING COSTS OF IMPROVEMENTS MADE AFTER THE DATE A VESSEL OR LNG TRANSPORTATION FACILITY WAS INITIALLY PLACED IN SERVICE, AND REDUCED BY THE

(A) CASH VALUE OF ANY FEDERAL INCOME TAX BENEFITS, SUCH AS INVESTMENT TAX CREDIT, OF ACQUIRING THE VESSEL, LNG TRANSPORTATION FACILITY, OR CAPITALIZED IMPROVEMENT; AND

(B) REASONABLE SALVAGE VALUE OF THE VESSEL, LNG TRANSPORTATION FACILITY, OR CAPITALIZED IMPROVEMENT;

(2) "AFTER FEDERAL INCOME TAX" MEANS AFTER APPLYING APPROPRIATE ADJUSTMENTS FOR THE FEDERAL INCOME TAX BENEFITS OF OWNING AND OPERATING THE VESSEL, LNG TRANSPORTATION FACILITY, OR CAPITALIZED IMPROVEMENT; THESE TAX BENEFITS INCLUDE TAX DEPRECIATION, FOREIGN TAX CREDITS GENERATED BY FOREIGN SOURCE INCOME DERIVED FROM THE USE OF THE VESSEL, LNG TRANSPORTATION FACILITY, OR CAPITALIZED IMPROVEMENT, CAPITAL CONSTRUCTION FUND CONTRIBUTIONS, AND INVESTMENT TAX CREDITS.

(b) FOR A VESSEL OR LNG TRANSPORTATION FACILITY PLACED IN SERVICE ON OR AFTER JANUARY 1, 1995, AND BEFORE JANUARY 1, 2002, OR FOR A CAPITALIZED IMPROVEMENT PLACED IN SERVICE ON OR AFTER JANUARY 1, 1995, AND BEFORE JANUARY 1, 2002, THAT EXTENDS THE LIFE OF A VESSEL OR LNG TRANSPORTATION FACILITY, (1) A REASONABLE RETURN INCLUDING DEPRECIATION UNDER 15 AAC 55.191(b)(3)(C) AND (D) OR 15 AAC 55.191(b)(4)(B)(III)

AND (IV) IS $99,000 PER YEAR FOR 24 YEARS FOR EACH $1,000,000 OF ADJUSTED SHIPYARD COST, FOR OIL OR GAS PRODUCED BEFORE JANUARY 1, 2002; AND (2) A COST OF CAPITAL ALLOWANCE WILL BE ALLOWED AS PROVIDED IN (d) OR (f) OF THIS SECTION OR 15 AAC 55.196, AS APPLICABLE, FOR OIL OR GAS PRODUCED ON OR AFTER JANUARY 1, 2002. FOR PURPOSES OF THIS SUBSECTION, "ADJUSTED SHIPYARD COST" MEANS THE TOTAL AMOUNT PAID TO THE PERSON BUILDING OR SELLING THE VESSEL, LNG TRANSPORTATION FACILITY, OR CAPITALIZED IMPROVEMENT TO THE PRODUCER, LESS ANY INVESTMENT TAX CREDIT TAKEN BY THE PRODUCER, OR IN THE CASE OF AN EFFECTIVELY OWNED VESSEL OR LNG TRANSPORTATION FACILITY, TAKEN BY THE LEGAL OWNER OF THAT VESSEL OR FACILITY AND PASSED ON IN WHOLE OR IN PART TO THE PRODUCER THROUGH REDUCED CHARTER-HIRE OR LEASE PAYMENTS, AND LESS ANY SALVAGE VALUE USED BY THE PRODUCER TO COMPUTE DEPRECIATION EXPENSE REPORTED TO SHAREHOLDERS AND OWNERS. IF A VESSEL, LNG TRANSPORTATION FACILITY, OR CAPITALIZED IMPROVEMENT IS ACQUIRED THROUGH A CONTRACT THAT STATES THE PURCHASE PRICE IN TERMS OF A FOREIGN CURRENCY, THE COST IS THE EQUIVALENT AMOUNT IN UNITED STATES DOLLARS AS DETERMINED BY APPLYING THE FOREIGN CURRENCY EXCHANGE RATE ON THE DATE THAT THE CONTRACT IS INITIALLY SIGNED. IF A MODIFICATION TO THE PURCHASE PRICE IS LATER MADE, THE FOREIGN CURRENCY EXCHANGE RATE ON THE DATE THAT THE MODIFICATION IS SIGNED MUST BE APPLIED TO THE AMOUNT BY WHICH THE PURCHASE PRICE IS CHANGED.

(c) FOR A CAPITALIZED IMPROVEMENT PLACED IN SERVICE ON OR AFTER JANUARY 1, 1995 AND BEFORE JANUARY 1, 2002, THAT DOES NOT EXTEND THE LIFE OF A VESSEL OR LNG TRANSPORTATION FACILITY,

(1) A REASONABLE RETURN INCLUDING DEPRECIATION UNDER 15 AAC 55.191(b)(3)(C) AND (D), 15 AAC 55.191(b)(4)(B)(III) AND (IV), 15 AAC 55.193(b)(3)(C) AND (D), OR 15 AAC 55.193(b)(4)(B)(III) AND (IV) IS $158,000 PER YEAR FOR 10 YEARS FOR EACH $1,000,000 OF ADJUSTED SHIPYARD COST AS DEFINED IN (b) OF THIS SECTION, FOR OIL OR GAS PRODUCED BEFORE JANUARY 1, 2002, AND ON OR AFTER JANUARY 1, 2003; AND

(2) A COST OF CAPITAL ALLOWANCE WILL BE ALLOWED AS PROVIDED IN (d) OR (h) OF THIS SECTION, AS APPLICABLE, FOR OIL OR GAS PRODUCED DURING CALENDAR YEAR 2002.

(d) FOR AN LNG TRANSPORTATION FACILITY FIRST PLACED IN SERVICE BY THE PRODUCER ON OR AFTER JANUARY 1, 1995, AND BEFORE JANUARY 1, 2011, OR A CAPITALIZED IMPROVEMENT TO THAT FACILITY, A COST OF CAPITAL ALLOWANCE THAT CONSISTS OF DEPRECIATION AND A RETURN ON ACQUISITION COST WILL BE ALLOWED FOR OIL OR GAS PRODUCED ON OR AFTER JANUARY 1, 2002. THE COST OF CAPITAL ALLOWANCE UNDER THIS SUBSECTION IS ALSO AVAILABLE FOR A PIPELINE FACILITY UNDER 15 AAC 55.191(b)(8), OR FOR A CAPITALIZED IMPROVEMENT THAT IS MADE TO THAT FACILITY. HOWEVER, AN IMPROVEMENT TO AN LNG TRANSPORTATION OR PIPELINE FACILITY THAT THE PRODUCER TREATS AS AN EXPENSE UNDER 26 U.S.C. 179 MAY NOT RECEIVE A COST OF CAPITAL ALLOWANCE UNDER THIS

SUBSECTION. THE COST OF CAPITAL ALLOWANCE UNDER THIS SUBSECTION IS AN AMOUNT TO BE CALCULATED ANNUALLY FOR A CALENDAR YEAR AS FOLLOWS:

(1) THE COST OF CAPITAL ALLOWANCE IS CALCULATED

(A) USING THE FOLLOWING FORMULA, EXCEPT AS PROVIDED IN (B) OF THIS PARAGRAPH: COST OF CAPITAL ALLOWANCE = INITIAL CASH FLOW/(1 - MARGINAL FEDERAL TAX RATE); AND

(B) FOR AN LNG TRANSPORTATION FACILITY FIRST PLACED IN SERVICE ON OR AFTER JANUARY 1, 1995 AND BEFORE JANUARY 1, 2002, FOR EACH YEAR BEFORE JANUARY 1, 2002, THE COST OF CAPITAL ALLOWANCE EQUALS THE TOTAL AFTER-TAX CASH FLOW;

(2) FOR PURPOSES OF THE FORMULAS SET OUT IN (1) AND (8) OF THIS SUBSECTION, INITIAL CASH FLOW IS CALCULATED USING THE FOLLOWING FORMULA: INITIAL CASH FLOW = (REMAINING UNRECOVERED INVESTMENT - AFTER-TAX PRESENT VALUE OF FUTURE TAX DEPRECIATION BENEFITS)/PRESENT VALUE OF AN ORDINARY ANNUITY OF 1 AT THE END OF n PERIODS, WHERE "n" IS YEARS OF REMAINING LIFE AT INTEREST RATE WACC;

(3) FOR PURPOSES OF THE FORMULA SET OUT IN (2) OF THIS SUBSECTION, REMAINING UNRECOVERED INVESTMENT IS CALCULATED USING THE FOLLOWING FORMULA: REMAINING UNRECOVERED INVESTMENT = (FINANCE COST - TOTAL AFTER-TAX CASH FLOW) * ((1 + WACC) *exp*. (PORTION OF YEAR IN SERVICE * 0.5));

(4) FOR PURPOSES OF THE FORMULA SET OUT IN (3) OF THIS SUBSECTION, FINANCE COST IS CALCULATED USING THE FOLLOWING FORMULA: FINANCE COST = REMAINING UNRECOVERED INVESTMENT FROM THE PRIOR YEAR * ((1 + WACC) *exp*. (PORTION OF YEAR IN SERVICE * 0.5));

(5) THE REMAINING UNRECOVERED INVESTMENT FROM THE PRIOR YEAR, FOR PURPOSES OF THE FORMULA SET OUT IN (4) OF THIS SUBSECTION, AND FOR

(A) THE FIRST YEAR THE FACILITY IS IN SERVICE, IS THE SUM OF THE UNRECOVERED INVESTMENTS FOR ALL YEARS THE FACILITY IS UNDER CONSTRUCTION; AND

(B) A FACILITY THAT IS IN SERVICE ON JANUARY 1, 2002, IS CALCULATED USING THE METHOD SET OUT IN THIS SUBSECTION AND AS IF THE FACILITY RECEIVED THE COST OF CAPITAL ALLOWANCES PROVIDED IN THIS SECTION FOR THE FACILITY'S YEARS OF SERVICE BEFORE JANUARY 1, 2002;

(6) FOR PURPOSES OF (5)(A) OF THIS SUBSECTION, AN UNRECOVERED INVESTMENT FOR A YEAR THE FACILITY IS UNDER CONSTRUCTION IS CALCULATED AS IF THE FACILITY WERE BUILT OVER A TWO-YEAR PERIOD BEFORE THE FIRST MONTH THE FACILITY IS FIRST PLACED IN SERVICE, WITH EQUAL AMOUNTS PAID EACH YEAR; UNRECOVERED INVESTMENT FOR A YEAR THE FACILITY IS UNDER CONSTRUCTION IS CALCULATED USING THE FOLLOWING FORMULA: UNRECOVERED INVESTMENT FOR A YEAR THE FACILITY IS UNDER CONSTRUCTION = TOTAL AMOUNT PAID TO

THE PERSON BUILDING OR SELLING THE FACILITY TO THE PRODUCER * 0.5 * PORTION OF THE CALENDAR YEAR THE FACILITY IS UNDER CONSTRUCTION * FINANCE FACTOR DURING CONSTRUCTION;

(7) FOR PURPOSES OF THE FORMULA SET OUT IN (6) OF THIS SUBSECTION, THE FINANCE FACTOR DURING CONSTRUCTION IS CALCULATED AS IF THE FACILITY WERE BUILT OVER A TWO-YEAR PERIOD BEFORE THE FIRST MONTH THE FACILITY IS FIRST PLACED IN SERVICE; THE FINANCE FACTOR DURING CONSTRUCTION IS CALCULATED USING THE FOLLOWING FORMULAS:

(A) FOR THE PORTION OF THE FIRST CALENDAR YEAR OF CONSTRUCTION, AND EXCEPT AS PROVIDED IN (B) OF THIS PARAGRAPH, THE FINANCE FACTOR DURING CONSTRUCTION = ((1 + WACC FOR THE FIRST CALENDAR YEAR OF CONSTRUCTION) *exp*. (PORTION OF THE FIRST CALENDAR YEAR THE FACILITY IS IN SERVICE * 0.5)) * (1 + WACC FOR THE SECOND CALENDAR YEAR OF CONSTRUCTION) * ((1 + WACC FOR THE THIRD CALENDAR YEAR OF CONSTRUCTION) *exp*. (1 - THE PORTION OF THE FIRST CALENDAR YEAR THE FACILITY IS IN SERVICE));

(B) FOR AN LNG TRANSPORTATION FACILITY FIRST PLACED IN SERVICE ON OR AFTER JANUARY 1, 1995 AND BEFORE JANUARY 1, 2002, THE FINANCE FACTOR DURING CONSTRUCTION IS CALCULATED AS IF THE PORTION OF THE FIRST CALENDAR YEAR THE FACILITY IS IN SERVICE IS ZERO;

(C) FOR THE SECOND CALENDAR YEAR OF CONSTRUCTION, THE FINANCE FACTOR DURING CONSTRUCTION = ((1 + WACC FOR THE

SECOND CALENDAR YEAR OF CONSTRUCTION) *exp*. (0.5)) * ((1 + WACC FOR THE THIRD CALENDAR YEAR OF CONSTRUCTION) *exp*. (1 - THE PORTION OF THE FIRST CALENDAR YEAR THE FACILITY IS IN SERVICE));

(D) FOR THE PORTION OF THE THIRD CALENDAR YEAR OF CONSTRUCTION, THE FINANCE FACTOR DURING CONSTRUCTION = (1 + WACC FOR THE THIRD CALENDAR YEAR OF CONSTRUCTION) *exp*. ((1 - THE PORTION OF THE FIRST CALENDAR YEAR THE FACILITY IS IN SERVICE) * 0.5);

(8) FOR PURPOSES OF (1)(B) OF THIS SUBSECTION AND THE FORMULA SET OUT IN (3) OF THIS SUBSECTION, TOTAL AFTER-TAX CASH FLOW IS CALCULATED USING THE FOLLOWING FORMULA: TOTAL AFTER-TAX CASH FLOW = INITIAL CASH FLOW + AFTER-TAX CASH FLOW OF DEPRECIATION BENEFITS FOR THAT TAX YEAR;

(9) FOR PURPOSES OF THE FORMULA SET OUT IN (8) OF THIS SUBSECTION, AFTER-TAX CASH FLOW OF DEPRECIATION BENEFITS FOR THAT TAX YEAR

(A) EXCEPT AS PROVIDED IN (B) OF THIS PARAGRAPH, IS CALCULATED USING THE FOLLOWING FORMULA: AFTER-TAX CASH FLOW OF DEPRECIATION BENEFITS FOR THAT TAX YEAR = TOTAL AMOUNT PAID TO THE PERSON BUILDING OR SELLING THE FACILITY TO THE PRODUCER * MARGINAL FEDERAL TAX RATE * FEDERAL DEPRECIATION FACTOR; AND

(B) EQUALS ZERO, FOR AN LNG TRANSPORTATION FACILITY FIRST PLACED IN SERVICE ON OR AFTER JANUARY 1, 1995 AND BEFORE JANUARY 1, 2002, FOR EACH YEAR BEFORE JANUARY 1, 2002;

(10) FOR PURPOSES OF THE FORMULAS SET OUT IN (9) AND (12) OF THIS SUBSECTION, THE FEDERAL DEPRECIATION FACTOR IS THE PERCENTAGE OF THE TOTAL AMOUNT PAID TO THE PERSON BUILDING OR SELLING THE FACILITY TO THE PRODUCER THAT CAN BE DEPRECIATED FOR FEDERAL CORPORATE INCOME TAX FOR THE TAX YEAR;

(11) FOR PURPOSES OF (2) OF THIS SUBSECTION, THE AFTER-TAX PRESENT VALUE OF FUTURE TAX DEPRECIATION BENEFITS

(A) EXCEPT AS PROVIDED IN (B) OF THIS PARAGRAPH, IS THE SUM OF THE DISCOUNTED ANNUAL TAX DEPRECIATION AMOUNTS FOR EACH REMAINING YEAR IN WHICH THE TOTAL AMOUNT PAID TO THE PERSON BUILDING OR SELLING THE FACILITY TO THE PRODUCER CAN BE DEPRECIATED FOR FEDERAL CORPORATE INCOME TAX FOR THE TAX YEAR; AND

(B) EQUALS ZERO, FOR AN LNG TRANSPORTATION FACILITY FIRST PLACED IN SERVICE ON OR AFTER JANUARY 1, 1995 AND BEFORE JANUARY 1, 2002, FOR EACH YEAR BEFORE JANUARY 1, 2002;

(12) FOR PURPOSES OF (11) OF THIS SUBSECTION, A DISCOUNTED ANNUAL TAX DEPRECIATION AMOUNT IS CALCULATED USING THE FOLLOWING FORMULA: DISCOUNTED ANNUAL TAX DEPRECIATION AMOUNT = FEDERAL DEPRECIATION FACTOR * TOTAL AMOUNT PAID TO THE PERSON BUILDING OR

SELLING THE FACILITY TO THE PRODUCER * MARGINAL FEDERAL TAX RATE * DISCOUNT FACTOR;

(13) FOR PURPOSES OF THE FORMULAS SET OUT IN (1), (9), AND (12) OF THIS SUBSECTION, THE MARGINAL FEDERAL TAX RATE

(A) EXCEPT AS PROVIDED IN (B) OF THIS PARAGRAPH, IS THE HIGHEST MARGINAL FEDERAL CORPORATE INCOME TAX RATE FOR THE CALENDAR YEAR; IF THE FEDERAL INCOME TAX RATE CHANGES DURING THE YEAR, THE DEPARTMENT WILL APPLY THE NEW TAX RATE TO THAT PORTION FOR THE YEAR THAT EQUALS THE NUMBER OF DAYS IN THE YEAR THAT INCLUDE AND FOLLOW THE DAY ON WHICH THE OLD TAX RATE CHANGED, DIVIDED BY THE TOTAL NUMBER OF DAYS IN THAT YEAR; AND

(B) EQUALS 35 PERCENT, FOR AN LNG TRANSPORTATION FACILITY FIRST PLACED IN SERVICE ON OR AFTER JANUARY 1, 1995 AND BEFORE JANUARY 1, 2002, FOR EACH YEAR BEFORE JANUARY 1, 2002;

(14) FOR PURPOSES OF THE FORMULA SET OUT IN (12) OF THIS SUBSECTION, THE DISCOUNT FACTOR IS CALCULATED USING THE FOLLOWING FORMULA: DISCOUNT FACTOR = 1/((1 + WACC) *exp*. (DISCOUNT FACTOR EXPONENT));

(15) FOR PURPOSES OF THE FORMULA SET OUT IN (14) OF THIS SUBSECTION, THE DISCOUNT FACTOR EXPONENT IS CALCULATED USING THE FOLLOWING FORMULA: DISCOUNT FACTOR EXPONENT = (((((1 - PORTION OF YEAR IN SERVICE) + 1) * 0.5) - 1) + YEAR DEPRECIATION BENEFIT IS REALIZED);

(16) FOR PURPOSES OF THE FORMULA SET OUT IN (2) OF THIS SUBSECTION, THE PRESENT VALUE OF AN ORDINARY ANNUITY OF 1 AT THE END OF n PERIODS, WHERE "n" IS YEARS OF REMAINING LIFE AT INTEREST RATE WACC, IS THE RESULT GENERATED BY THE FOLLOWING FORMULA: (((1 - (1/((1+WACC) *exp*. (YEARS OF REMAINING LIFE))))/WACC)/((1+WACC) *exp*. (-0.5)))/PORTION OF YEAR IN SERVICE;

(17) FOR PURPOSES OF THE FORMULA SET OUT IN (16) OF THIS SUBSECTION, YEARS OF REMAINING LIFE MUST BE DETERMINED FOR EACH

(A) COMPONENT OF THE FACILITY THAT IS IN SERVICE AT THE START-UP OF THE FACILITY AS IF THAT COMPONENT HAD A 30-YEAR LIFE, EXCEPT THAT FOR LNG TRANSPORTATION FACILITIES FIRST PLACED IN SERVICE ON OR AFTER JANUARY 1, 1995 AND BEFORE JANUARY 1, 2002, YEARS OF REMAINING LIFE MUST BE DETERMINED, FOR EACH YEAR BEFORE JANUARY 1, 2002, AS IF THAT COMPONENT HAD A 24-YEAR LIFE;

(B) CAPITALIZED IMPROVEMENT THAT EXTENDS THE LIFE OF A FACILITY AND THAT IS PUT IN SERVICE AFTER START-UP OF THE FACILITY AS IF THAT CAPITALIZED IMPROVEMENT HAD A 15-YEAR LIFE; AND

(C) CAPITALIZED IMPROVEMENT THAT DOES NOT EXTEND THE LIFE OF A FACILITY AND THAT IS PUT IN SERVICE AFTER START-UP OF THE FACILITY AS IF THAT CAPITALIZED IMPROVEMENT HAD A 10-YEAR LIFE;

(18) FOR PURPOSES OF THE FORMULAS SET OUT IN (2), (3), (4), (7), (14), AND (16) OF THIS SUBSECTION, WACC OR THE WEIGHTED AVERAGE COST OF CAPITAL,

(A) FOR A CALENDAR YEAR BEFORE 1997,

(i) EXCEPT AS PROVIDED IN (ii) OF THIS SUBPARAGRAPH, IS 10 PERCENT; AND

(ii) IS EIGHT PERCENT, FOR AN LNG TRANSPORTATION FACILITY FIRST PLACED IN SERVICE ON OR AFTER JANUARY 1, 1995 AND BEFORE JANUARY 1, 2002, FOR EACH YEAR BEFORE JANUARY 1, 2002; AND

(B) FOR 1997 OR A LATER CALENDAR YEAR,

(i) EXCEPT AS PROVIDED IN (ii) OF THIS SUBPARAGRAPH, IS THE COST OF CAPITAL, AS REASONABLY DETERMINED BY THE DEPARTMENT, FOR THE CATEGORY OF BUSINESS DESCRIBED FOR STANDARD INDUSTRIAL CLASSIFICATION (SIC) INDUSTRY NO. 4924, IN THE EXECUTIVE OFFICE OF THE PRESIDENT, OFFICE OF MANAGEMENT AND BUDGET, *STANDARD INDUSTRIAL CLASSIFICATION MANUAL*, AS REVISED AS OF 1987; AS DESCRIBED IN THIS SUBPARAGRAPH, SIC INDUSTRY NO. 4924 IS ADOPTED BY REFERENCE; IN DETERMINING A COST OF CAPITAL FOR A CALENDAR YEAR UNDER THIS SUB-SUBPARAGRAPH, THE DEPARTMENT WILL PRESUME, IN THE ABSENCE OF FACTS TO THE CONTRARY, THAT THE COST OF

CAPITAL IS ACCURATELY REPRESENTED BY THE WEIGHTED AVERAGE COST OF CAPITAL USING THE CAPITAL ASSET PRICING MODEL (CAPM), ORDINARY LEAST SQUARES (OLS) FOR THE INDUSTRIAL COMPOSITE FOR SIC CODE NUMBER 4924, AS REPORTED IN DUFF & PHELPS, *VALUATION HANDBOOK, INDUSTRY COST OF CAPITAL*, PUBLISHED DURING THE PREVIOUS CALENDAR YEAR, PLUS, FOR LNG TRANSPORTATION FACILITIES, 0.2 PERCENT AFTER DECEMBER 31, 2001; AND

(ii) IS EIGHT PERCENT, FOR AN LNG TRANSPORTATION FACILITY FIRST PLACED IN SERVICE ON OR AFTER JANUARY 1, 1995 AND BEFORE JANUARY 1, 2002, FOR EACH YEAR BEFORE JANUARY 1, 2002;

(19) FOR PURPOSES OF THE FORMULA SET OUT IN (16) OF THIS SUBSECTION, FOR FACILITIES THAT COME INTO SERVICE MIDYEAR, THE PORTION OF THE YEAR IN SERVICE FOR THE FIRST AND LAST CALENDAR YEARS THE FACILITY IS IN SERVICE IS THE NUMBER OF DAYS THE FACILITY IS IN SERVICE DURING THE YEAR DIVIDED BY 365, AND 100 PERCENT FOR ALL OTHER YEARS.

(e) THE FOLLOWING EXAMPLE ILLUSTRATES (d) OF THIS SECTION:

TAXPAYER A PLACES A FACILITY INTO SERVICE IN YEAR ONE. THE TOTAL AMOUNT PAID TO THE PERSON BUILDING OR SELLING THE FACILITY IS $1,000,000. THE FACILITY COMES INTO SERVICE 75 PERCENT OF THE WAY INTO YEAR ONE; IT IS IN SERVICE 25 PERCENT OF THE YEAR. FOR THE FIRST PARTIAL CALENDAR YEAR OF CONSTRUCTION, THE TAX RATE IS 34 PERCENT AND THE

WACC IS FIVE PERCENT. FOR THE SECOND FULL CALENDAR YEAR OF CONSTRUCTION, THE TAX RATE IS 35 PERCENT AND THE WACC IS SIX PERCENT. FOR THE THIRD PARTIAL CALENDAR YEAR OF CONSTRUCTION, THE TAX RATE IS 37 PERCENT AND THE WACC IS EIGHT PERCENT. FOR THE FIRST YEAR OF SERVICE THE TAX RATE AND WACC ARE THE SAME AS FOR THE THIRD YEAR OF CONSTRUCTION: THE TAX RATE IS 37 PERCENT AND THE WACC IS EIGHT PERCENT. THE FEDERAL DEPRECIATION FACTORS ARE AS FOLLOWS:

YEAR 1 = 15%

YEAR 2 = 22%

YEAR 3 = 21%

YEAR 4 = 21%

YEAR 5 = 21%

BECAUSE THE FACILITY BEGINS SERVICE MID-YEAR, THE FEDERAL DEPRECIATION FACTORS ARE WEIGHTED FOR TIME IN SERVICE AS FOLLOWS:

YEAR 1 = (0.25 * 15%) = 0.0375

YEAR 2 = (0.75 * 15%) + (0.25 * 22%) = 0.1675

YEAR 3 = (0.75 * 22%) + (0.25 * 21%) = 0.2175

YEAR 4 = (0.75 * 21%) + (0.25 * 21%) = 0.2100

YEAR 5 = (0.75 * 21%) + (0.25 * 21%) = 0.2100

YEAR 6 = (0.75 * 21%) = 0.1575

STEP ONE: CALCULATE THE FINANCE FACTOR DURING CONSTRUCTION FOR THE THREE YEARS OF CONSTRUCTION UNDER (d)(7) OF THIS SECTION:

FOR THE FIRST CALENDAR YEAR OF CONSTRUCTION THE FINANCE FACTOR DURING CONSTRUCTION WOULD BE:

(((1 + 0.05) *exp*. (0.25 * 0.5)) * (1 + 0.06) * ((1 + 0.08) *exp*. (1 - 0.25)) = 1.129854044

FOR THE SECOND CALENDAR YEAR OF CONSTRUCTION THE FINANCE FACTOR DURING CONSTRUCTION WOULD BE:

(((1 + 0.06) *exp*. (0.5)) * ((1+0.08) *exp*. (1 - 0.25)) = 1.090738767

FOR THE THIRD CALENDAR YEAR OF CONSTRUCTION THE FINANCE FACTOR DURING CONSTRUCTION WOULD BE:

(1 + 0.08) *exp*. (((1 - 0.25) * 0.5) = 1.029280887

STEP TWO: CALCULATE THE UNRECOVERED INVESTMENT FOR THE THREE YEARS OF CONSTRUCTION UNDER (d)(6) OF THIS SECTION:

FOR THE FIRST YEAR OF CONSTRUCTION THE UNRECOVERED INVESTMENT WOULD BE:

1,000,000 * 0.5 * 0.25 * 1.129854044 = 141,232

FOR THE SECOND YEAR OF CONSTRUCTION THE UNRECOVERED INVESTMENT WOULD BE:

1,000,000 * 0.5 * 1.00 * 1.090738767 = 545,369

FOR THE THIRD YEAR OF CONSTRUCTION THE UNRECOVERED INVESTMENT WOULD BE:

1,000,000 * 0.5 * 0.75 * 1.029280887 = 385,980

STEP THREE: CALCULATE THE REMAINING UNRECOVERED INVESTMENT FROM THE PRIOR YEAR FOR YEAR ONE UNDER (d)(5) OF THIS SECTION:

141,232 + 545,369 + 385,980 = 1,072,581

STEP FOUR: CALCULATE THE DISCOUNT FACTOR EXPONENT FOR YEAR ONE UNDER (d)(15) OF THIS SECTION:

(((((1 - 0.25) + 1) * 0.5) - 1) + 1) = 0.875

STEP FIVE: CALCULATE THE DISCOUNT FACTOR FOR YEAR ONE UNDER (d)(14) OF THIS SECTION:

1 / ((1 + 0.08) *exp*. (0.875)) = 0.935

STEP SIX: CALCULATE THE DISCOUNTED ANNUAL TAX DEPRECIATION AMOUNT FOR YEAR ONE UNDER (d)(12) OF THIS SECTION:

0.0375 * 1,000,000 * 0.37 * 0.935 = 12,971

STEP SEVEN: CALCULATE THE AFTER-TAX PRESENT VALUE OF FUTURE TAX DEPRECIATION BENEFITS FOR YEAR ONE UNDER (d)(11) OF THIS SECTION BY ADDING THE DISCOUNTED TAX DEPRECIATION AMOUNTS FOR THE FIRST FIVE COMPLETE YEARS:

YEAR 1 = 0.0375 * 1,000,000 * 0.37 * 0.935 = 12,971

YEAR 2 = 0.1675 * 1,000,000 * 0.37 * 0.891 = 55,218

YEAR 3 = 0.2175 * 1,000,000 * 0.37 * 0.825 = 66,390

YEAR 4 = 0.2100 * 1,000,000 * 0.37 * 0.764 = 59,352

YEAR 5 = 0.2100 * 1,000,000 * 0.37 * 0.707 = 54,956

YEAR 6 = 0.1575 * 1,000,000 * 0.37 * 0.655 = 38,164

TOTAL = 287,051.

TABLE 1 SHOWS THE DERIVATION OF THE AFTER-TAX PRESENT VALUE OF FUTURE TAX DEPRECIATION BENEFITS FOR YEARS ONE - SIX.

STEP EIGHT: CALCULATE THE FINANCE COST FOR YEAR ONE UNDER (d)(4) OF THIS SECTION:

1,072,581 * ((1 + 0.08) *exp*. (0.25 * 0.5)) = 1,082,950

STEP NINE: CALCULATE THE PRESENT VALUE OF AN ORDINARY ANNUITY OF 1 FOR YEAR ONE UNDER (d)(16) OF THIS SECTION:

(((1 - (1 / ((1 + 0.08) *exp*. (30))))/0.08) / ((1 + 0.08) *exp*. (-0.5)))/0.25 = 46.79773

STEP TEN: CALCULATE THE INITIAL CASH FLOW UNDER (d)(2) OF THIS SECTION:

(1,072,581 - 287,051) / 46.79773 = 16,786

STEP ELEVEN: CALCULATE THE COST OF CAPITAL ALLOWANCE UNDER (d)(1) OF THIS SECTION:

16,786 / (1 - 0.37) = 26,644

STEP TWELVE: CALCULATE THE AFTER-TAX CASH FLOW OF DEPRECIATION BENEFITS FOR YEAR ONE UNDER (d)(9) OF THIS SECTION:

1,000,000 * 0.37 * 0.0375 = 13,875

STEP THIRTEEN: CALCULATE THE TOTAL AFTER-TAX CASH FLOW FOR YEAR ONE UNDER (d)(8) OF THIS SECTION:

16,786 + 13,875 = 30,661

STEP FOURTEEN: CALCULATE THE REMAINING UNRECOVERED INVESTMENT AT THE END OF YEAR ONE UNDER (D)(3) OF THIS SECTION:

(1,082,950 - 30,661) * ((1 + .08) *exp*. (0.25 * 0.5)) = 1,062,461

TABLE 2 SHOWS THE CAPITAL CONSTRUCTION ALLOWANCES FOR THE REMAINING YEARS USING THE TAX RATES AND WACCS GIVEN IN THE EXAMPLE.

TABLE 1: AFTER-TAX PRESENT VALUE

OF FUTURE DEPRECIATION BENEFITS

TABLE 1: AFTER-TAX PRESENT VALUE OF FUTURE DEPRECIATION BENEFITS

	Unadjusted Federal Depreciation Factor	Depreciation Factor Adjusted for Partial Year Start-Up	Year Depreciation Benefit Realized	Discount Factor Exponent	Discount Factor	Present Value Annual Tax Depreciation Amount
Year 1	0	0.0375	1	0.875	0.935	12,971
	0.15	0.1675	2	1.500	0.891	55,218
	0.22	0.2175	3	2.500	0.825	66,390
	0.21	0.2100	4	3.500	0.764	59,352
	0.21	0.2100	5	4.500	0.707	54,956
	0.21	0.1575	6	5.500	0.655	38,164
					total	287,051
Year 2	0.22	0.1675	1	0.500	0.958	60,966
	0.21	0.2175	2	1.500	0.879	72,628
	0.21	0.2100	3	2.500	0.806	64,333
	0.21	0.2100	4	3.500	0.740	59,021
	0	0.1575	5	4.500	0.679	40,611
					total	297,560
Year 3	0.21	0.2175	1	0.500	0.953	80,877
	0.21	0.2100	2	1.500	0.867	70,990
	0.21	0.2100	3	2.500	0.788	64,536
	0	0.1575	4	3.500	0.716	44,002
					total	260,405
Year 4	0.21	0.2100	1	0.500	0.949	79,729
	0.21	0.2100	2	1.500	0.855	71,828
	0	0.1575	3	2.500	0.770	48,533
					total	200,090
Year 5	0.21	0.2100	1	0.500	0.945	81,357
	0	0.1575	2	1.500	0.844	54,480
					total	135,837
Year 6	0	0.1575	1	0.500	0.941	62,229
					total	62,229

TABLE 2: COST OF CAPITAL ALLOWANCE FOR LNG AND PIPELINE FACILITIES

TABLE 2: COST OF CAPITAL ALLOWANCE FOR LNG AND PIPELINE FACILITIES

Year	Portion of Year in Service	Tax Rate	Weighted Average Cost Of Capital	Remaining Years	After-Tax Present Value (ATPV) of Future Tax Depreciation	Finance Cost	Finance Cost Minus Total After-Tax Cash Flow
1	25%	0.37	0.08	30.00	287,051	1,082,950	1,052,289
2	100%	0.38	0.09	29.75	297,560	1,109,242	974,152
3	100%	0.39	0.10	28.75	260,405	1,066,686	904,739
4	100%	0.40	0.11	27.75	200,090	999,726	832,974
5	100%	0.41	0.12	26.75	135,837	926,756	754,286
6	100%	0.42	0.13	25.75	62,229	848,563	688,359
7	100%	0.43	0.14	24.75	0	781,280	681,434
8	100%	0.44	0.15	23.75	0	780,235	674,645
9	100%	0.45	0.14	22.75	0	772,462	672,526
10	100%	0.44	0.13	21.75	0	763,310	668,879
11	100%	0.43	0.12	20.75	0	752,481	663,373
12	100%	0.42	0.11	19.75	0	739,654	655,661
13	100%	0.41	0.10	18.75	0	724,498	645,388
14	100%	0.40	0.09	17.75	0	706,692	632,207
15	100%	0.39	0.08	16.75	0	685,938	615,804
16	100%	0.38	0.07	15.75	0	661,983	595,914
17	100%	0.37	0.06	14.75	0	634,641	572,341
18	100%	0.36	0.05	13.75	0	603,813	544,981
19	100%	0.35	0.06	12.75	0	574,949	512,875
20	100%	0.36	0.07	11.75	0	546,206	481,048
21	100%	0.37	0.08	10.75	0	517,121	449,058
22	100%	0.38	0.09	9.75	0	487,222	416,445
23	100%	0.39	0.10	8.75	0	456,002	382,719
24	100%	0.40	0.11	7.75	0	422,900	347,334
25	100%	0.41	0.12	6.75	0	387,274	309,665
26	100%	0.42	0.13	5.75	0	348,370	268,973
27	100%	0.43	0.14	4.75	0	305,281	224,366
28	100%	0.44	0.15	3.75	0	256,897	174,752
29	100%	0.45	0.16	2.75	0	201,837	118,764
30	100%	0.46	0.17	1.75	0	138,359	54,679
31	75%	0.47	0.18	0.75	0	62,932	–31

(continued)

TABLE 2: COST OF CAPITAL ALLOWANCE FOR LNG AND PIPELINE FACILITIES (CONT.)

TABLE 2: COST OF CAPITAL ALLOWANCE FOR LNG AND PIPELINE FACILITIES (cont.)

Year	Remaining Unrecovered Investment	Unrecovered Investment minus ATPV Future Tax Depreciation	Present Value Annuity	Initial Cash Flow	After-Tax Cash Flow Depreciation Benefits	Total After-Tax Cash Flow (TATCF)	Cost of Capital Allowance
1	1,062,461	785,530	46.79773	16,786	13,875	30,661	26,644
2	1,017,045	764,901	10.70697	71,440	63,650	135,090	115,225
3	948,898	756,640	9.81098	77,122	84,825	161,947	126,429
4	877,592	748,808	9.04874	82,753	84,000	166,753	137,921
5	798,261	741,755	8.39372	88,370	86,100	174,470	149,780
6	731,736	736,032	7.82562	94,054	66,150	160,204	162,163
7	727,573	731,736	7.32868	99,845	0	99,845	175,167
8	723,477	727,573	6.89057	105,590	0	105,590	188,553
9	718,062	723,477	7.23946	99,935	0	99,935	181,700
10	711,028	718,062	7.60405	94,431	0	94,431	168,628
11	702,048	711,028	7.97941	89,108	0	89,108	156,329
12	690,782	702,048	8.35848	83,992	0	83,992	144,814
13	676,888	690,782	8.73185	79,111	0	79,111	134,086
14	660,044	676,888	9.08758	74,485	0	74,485	124,142
15	639,963	660,044	9.41128	70,133	0	70,133	114,973
16	616,418	639,963	9.68630	66,069	0	66,069	106,563
17	589,261	616,418	9.89431	62,300	0	62,300	98,889
18	558,440	589,261	10.01606	58,832	0	58,832	91,924
19	528,037	558,440	8.99634	62,074	0	62,074	95,499
20	497,600	528,037	8.10405	65,157	0	65,157	101,808
21	466,674	497,600	7.31080	68,064	0	68,064	108,038
22	434,781	466,674	6.59352	70,778	0	70,778	114,158
23	401,399	434,781	5.93286	73,284	0	73,284	120,137
24	365,939	401,399	5.31192	75,566	0	75,566	125,943
25	327,718	365,939	4.71518	77,609	0	77,609	131,540
26	285,922	327,718	4.12760	79,397	0	79,397	136,891
27	239,558	285,922	3.53363	80,914	0	80,914	141,955
28	187,401	239,558	2.91628	82,145	0	82,145	146,688
29	127,913	187,401	2.25587	83,072	0	83,072	151,041
30	59,145	127,913	1.52860	83,680	0	83,680	154,963
31	−33	59,145	0.93935	62,964	0	62,964	118,799

(f) FOR A VESSEL FIRST PLACED IN SERVICE ON OR AFTER JANUARY 1, 1995, OR FOR AN IMPROVEMENT THAT EXTENDS THE LIFE OF A VESSEL AND THAT WAS FIRST PLACED IN SERVICE ON OR AFTER JANUARY 1, 1995, A COST OF CAPITAL ALLOWANCE THAT CONSISTS OF DEPRECIATION AND A RETURN ON INVESTMENT WILL BE ALLOWED FOR OIL OR GAS PRODUCED DURING CALENDAR YEAR 2002, EXCEPT THAT A PRODUCER MAY ELECT TO EXPENSE THE FIRST $1,000,000 IN COSTS INCURRED WITH RESPECT TO IMPROVEMENTS DURING CALENDAR YEAR 2002. AN AMOUNT EXPENSED MAY BE EITHER DEDUCTED IN THE MONTH INCURRED OR AMORTIZED OVER ALL MONTHS IN CALENDAR YEAR 2002. THE COST OF CAPITAL ALLOWANCE UNDER THIS SUBSECTION IS AN AMOUNT TO BE CALCULATED ANNUALLY FOR A CALENDAR YEAR AS FOLLOWS:

(1) THE COST OF CAPITAL ALLOWANCE IS CALCULATED

(A) USING THE FOLLOWING FORMULA, EXCEPT AS PROVIDED IN (B) OF THIS PARAGRAPH: COST OF CAPITAL ALLOWANCE = AFTER-TAX CASH FLOW / (1 - MARGINAL FEDERAL TAX RATE); AND

(B) FOR A VESSEL THAT WAS FIRST PLACED IN SERVICE ON OR AFTER JANUARY 1, 1995 AND BEFORE JANUARY 1, 2002, OR FOR A CAPITALIZED IMPROVEMENT THAT EXTENDS THE LIFE OF A VESSEL AND THAT WAS FIRST PLACED IN SERVICE ON OR AFTER JANUARY 1, 1995 AND BEFORE JANUARY 1, 2002, FOR EACH YEAR BEFORE JANUARY 1, 2002, THE COST OF CAPITAL ALLOWANCE EQUALS AFTER-TAX CASH FLOW;

(2) FOR PURPOSES OF (1) OF THIS SUBSECTION, AFTER-TAX CASH FLOW IS CALCULATED USING THE FOLLOWING FORMULA: AFTER-TAX CASH FLOW = REMAINING UNRECOVERED INVESTMENT FROM THE PRIOR YEAR / PRESENT VALUE OF AN ORDINARY ANNUITY OF 1 AT THE END OF THE REMAINING LIFE AT INTEREST RATE WACC;

(3) FOR PURPOSES OF THE FORMULA SET OUT IN (2) OF THIS SUBSECTION, REMAINING UNRECOVERED INVESTMENT IS CALCULATED USING THE FOLLOWING FORMULA: REMAINING UNRECOVERED INVESTMENT = ((MID-YEAR UNRECOVERED INVESTMENT - AFTER-TAX CASH FLOW) * ((1 + WACC) *exp*. (PORTION OF YEAR IN SERVICE * 0.5))) - VALUE OF ANY FEDERAL TAX CREDITS, DEDUCTIONS, OR BENEFITS THAT ARE ALLOWABLE UNDER 26 U.S.C. (INTERNAL REVENUE CODE), INCLUDING ANY TAX DEPRECIATION DEDUCTIONS AND CAPITAL CONSTRUCTION FUND BENEFIT, AND THAT WERE NOT INCLUDED IN THE CALCULATION MADE UNDER (6)(A) OR (C) OF THIS SUBSECTION IN THE YEAR FOR WHICH THE TAX IS PAID;

(4) FOR PURPOSES OF THE FORMULA SET OUT IN (2) OF THIS SUBSECTION, REMAINING UNRECOVERED INVESTMENT FOR THE FIRST YEAR THE VESSEL IS IN SERVICE IS THE NET UNRECOVERED CAPITAL INVESTMENT;

(5) FOR PURPOSES OF THE FORMULA SET OUT IN (3) OF THIS SUBSECTION, MID-YEAR UNRECOVERED INVESTMENT IS CALCULATED USING THE FOLLOWING FORMULA: MID-YEAR UNRECOVERED INVESTMENT = REMAINING UNRECOVERED INVESTMENT FROM THE PRIOR YEAR * ((1 + WACC) *exp*. (PORTION OF YEAR IN SERVICE * 0.5));

(6) FOR PURPOSES OF (4) OF THIS SUBSECTION, NET UNRECOVERED CAPITAL INVESTMENT IS THE TOTAL AMOUNT PAID TO THE PERSON BUILDING OR SELLING THE VESSEL TO THE PRODUCER, INCLUDING ANY IMPROVEMENTS TO EXISTING VESSELS,

(A) MINUS ANY INVESTMENT TAX CREDIT TAKEN BY THE PRODUCER UNDER 26 U.S.C. 38 (INTERNAL REVENUE CODE), OR IN THE CASE OF AN EFFECTIVELY OWNED VESSEL, AS DESCRIBED IN 15 AAC 55.191(k), TAKEN BY THE LEGAL OWNER OF THAT VESSEL OR FACILITY AND PASSED ON IN WHOLE OR IN PART TO THE PRODUCER THROUGH REDUCED CHARTER-HIRE OR LEASE PAYMENTS; THIS SUBPARAGRAPH DOES NOT APPLY TO VESSELS FIRST PLACED IN SERVICE ON OR AFTER JANUARY 1, 1995 AND BEFORE JANUARY 1, 2002, FOR EACH YEAR BEFORE JANUARY 1, 2002;

(B) MINUS THE AFTER-TAX NET PRESENT VALUE OF THE SALVAGE VALUE OF THE VESSEL IN YEAR 25; THIS SUBPARAGRAPH DOES NOT APPLY TO VESSELS FIRST PLACED IN SERVICE ON OR AFTER JANUARY 1, 1995 AND BEFORE JANUARY 1, 2002, FOR EACH YEAR BEFORE JANUARY 1, 2002;

(C) MINUS THE NET PRESENT VALUE IN THE FIRST YEAR THE VESSEL IS IN SERVICE OF ANY OTHER FEDERAL TAX CREDITS, DEDUCTIONS, OR BENEFITS ALLOWABLE UNDER 26 U.S.C. (INTERNAL REVENUE CODE), INCLUDING ANY TAX DEPRECIATION DEDUCTIONS AND CAPITAL CONSTRUCTION FUND BENEFIT, WHERE APPROPRIATE; THIS

SUBPARAGRAPH DOES NOT APPLY TO VESSELS FIRST PLACED IN SERVICE ON OR AFTER JANUARY 1, 1995 AND BEFORE JANUARY 1, 2002, FOR EACH YEAR BEFORE JANUARY 1, 2002; AND

(D) PLUS A RETURN ON CAPITAL USED DURING CONSTRUCTION;

(7) FOR PURPOSES OF (6) OF THIS SUBSECTION, A RETURN ON CAPITAL USED DURING CONSTRUCTION IS THE SUM OF THE YEARLY CONSTRUCTION COST OF CAPITAL FOR EACH YEAR OF CONSTRUCTION, CALCULATED AS IF THE VESSEL WERE BUILT OVER A TWO-YEAR PERIOD BEFORE THE FIRST MONTH THE VESSEL IS FIRST PLACED IN SERVICE, WITH EQUAL AMOUNTS PAID EACH YEAR;

(8) FOR PURPOSES OF THE FORMULA SET OUT IN (7) OF THIS SUBSECTION, YEARLY CONSTRUCTION COST OF CAPITAL FOR A YEAR IS CALCULATED USING THE FOLLOWING FORMULA: YEARLY CONSTRUCTION COST OF CAPITAL = CONSTRUCTION UNRECOVERED INVESTMENT - YEARLY OUTLAY;

(9) FOR PURPOSES OF THE FORMULAS SET OUT IN (8) AND (10) OF THIS SUBSECTION, YEARLY OUTLAY IS CALCULATED AS IF THE VESSEL WERE BUILT OVER A TWO-YEAR PERIOD BEFORE THE FIRST MONTH THE IS FIRST PLACED IN SERVICE, WITH EQUAL AMOUNTS PAID EACH YEAR; YEARLY OUTLAY IS CALCULATED USING THE FOLLOWING FORMULAS:

(A) FOR THE PORTION OF THE FIRST CALENDAR YEAR OF CONSTRUCTION, AND EXCEPT AS PROVIDED IN (B) OF THIS PARAGRAPH, YEARLY OUTLAY = PORTION OF THE YEAR IN SERVICE FOR THE FIRST

CALENDAR YEAR THE VESSEL IS IN SERVICE * 0.5 * TOTAL AMOUNT PAID TO THE PERSON BUILDING OR SELLING THE VESSEL TO THE PRODUCER;

(B) FOR A VESSEL THAT WAS FIRST PLACED IN SERVICE ON OR AFTER JANUARY 1, 1995 AND BEFORE JANUARY 1, 2002, OR FOR A CAPITALIZED IMPROVEMENT THAT EXTENDS THE LIFE OF A VESSEL AND THAT WAS FIRST PLACED IN SERVICE ON OR AFTER JANUARY 1, 1995 AND BEFORE JANUARY 1, 2002, THE YEARLY OUTLAY IS CALCULATED AS IF THE PORTION OF THE FIRST CALENDAR YEAR THE VESSEL IS IN SERVICE WERE ZERO;

(C) FOR THE SECOND CALENDAR YEAR OF CONSTRUCTION, YEARLY OUTLAY = 0.5 * TOTAL AMOUNT PAID TO THE PERSON BUILDING OR SELLING THE VESSEL TO THE PRODUCER;

(D) FOR THE PORTION OF THE THIRD CALENDAR YEAR OF CONSTRUCTION, YEARLY OUTLAY = (1 - THE PORTION OF THE YEAR IN SERVICE FOR THE FIRST CALENDAR YEAR THE VESSEL IS IN SERVICE) * 0.5 * TOTAL AMOUNT PAID TO THE PERSON BUILDING OR SELLING THE VESSEL TO THE PRODUCER;

(10) FOR PURPOSES OF THE FORMULA SET OUT IN (8) OF THIS SUBSECTION, CONSTRUCTION UNRECOVERED INVESTMENT IS CALCULATED USING THE FOLLOWING FORMULA: CONSTRUCTION UNRECOVERED INVESTMENT = YEARLY OUTLAY * CONSTRUCTION FINANCE FACTOR DURING CONSTRUCTION;

(11) FOR PURPOSES OF THE FORMULA SET OUT IN (10) OF THIS SUBSECTION, THE CONSTRUCTION FINANCE FACTOR DURING CONSTRUCTION IS CALCULATED USING THE FOLLOWING FORMULAS:

(A) FOR THE PORTION OF THE FIRST CALENDAR YEAR OF CONSTRUCTION, THE CONSTRUCTION FINANCE FACTOR DURING CONSTRUCTION = ((1 + WACC FOR THE FIRST CALENDAR YEAR OF CONSTRUCTION) *exp*. (PORTION OF THE FIRST CALENDAR YEAR THE VESSEL IS IN SERVICE * 0.5)) * (1 + WACC FOR THE SECOND CALENDAR YEAR OF CONSTRUCTION) * ((1 + WACC FOR THE THIRD CALENDAR YEAR OF CONSTRUCTION) *exp*. (1 - THE PORTION OF THE FIRST CALENDAR YEAR THE VESSEL IS IN SERVICE));

(B) FOR THE SECOND CALENDAR YEAR OF CONSTRUCTION, THE CONSTRUCTION FINANCE FACTOR DURING CONSTRUCTION = ((1 + WACC FOR THE SECOND CALENDAR YEAR OF CONSTRUCTION) *exp*. (0.5)) * ((1 + WACC FOR THE THIRD CALENDAR YEAR OF CONSTRUCTION) *exp*. (1 - THE PORTION OF THE FIRST CALENDAR YEAR THE VESSEL IS IN SERVICE));

(C) FOR THE PORTION OF THE THIRD CALENDAR YEAR OF CONSTRUCTION, THE CONSTRUCTION FINANCE FACTOR DURING CONSTRUCTION = (1 + WACC FOR THE THIRD CALENDAR YEAR OF CONSTRUCTION) *exp*. ((1 - THE PORTION OF THE FIRST CALENDAR YEAR THE VESSEL IS IN SERVICE) * 0.5);

(12) FOR PURPOSES OF (6) OF THIS SUBSECTION, AFTER-TAX NET PRESENT VALUE OF THE SALVAGE VALUE OF THE VESSEL IN YEAR 25 IS

CALCULATED USING THE FOLLOWING FORMULA: AFTER-TAX NET PRESENT VALUE OF THE SALVAGE VALUE OF THE VESSEL IN YEAR 25 = 0.04 * TOTAL AMOUNT PAID TO THE PERSON BUILDING OR SELLING THE VESSEL * (1 - MARGINAL FEDERAL TAX RATE FOR THE FIRST YEAR THE VESSEL IS IN SERVICE) * SALVAGE VALUE DISCOUNT FACTOR;

(13) FOR PURPOSES OF THE FORMULA SET OUT IN (12) OF THIS SUBSECTION, SALVAGE VALUE DISCOUNT FACTOR IS CALCULATED USING THE FOLLOWING FORMULA: SALVAGE VALUE DISCOUNT FACTOR = (1 / ((1 + WACC FOR THE FIRST YEAR THE VESSEL IS IN SERVICE) *exp*. (24.5)));

(14) FOR PURPOSES OF THE FORMULA SET OUT IN (2) OF THIS SUBSECTION, PRESENT VALUE OF AN ORDINARY ANNUITY OF 1 AT THE END OF THE REMAINING LIFE IS CALCULATED USING THE FOLLOWING FORMULA: PRESENT VALUE OF AN ORDINARY ANNUITY OF 1 AT THE END OF THE REMAINING LIFE = (((1 - (1 / ((1 + WACC) *exp*. (YEARS OF REMAINING LIFE)))) / WACC) / ((1 + WACC) *exp*. (-0.5))) / PORTION OF YEAR IN SERVICE;

(15) FOR PURPOSES OF THE FORMULA SET OUT IN (14) OF THIS SUBSECTION, YEARS OF REMAINING LIFE MUST BE DETERMINED FOR A VESSEL AS IF THE VESSEL HAD A 24-YEAR LIFE BEGINNING ON THE FIRST DAY OF THE MONTH THAT THE VESSEL TAKES ON ITS FIRST LOAD OF OIL, AND FOR A CAPITALIZED IMPROVEMENT THAT EXTENDS THE LIFE OF A VESSEL, AS IF THE CAPITALIZED IMPROVEMENT HAD A 15-YEAR LIFE BEGINNING ON THE FIRST DAY OF THE MONTH THAT THE VESSEL WITH THE NEW IMPROVEMENT TAKES ON A LOAD OF OIL; THE LIFE OF THE VESSEL OR CAPITALIZED IMPROVEMENT

WILL NOT BE SUSPENDED DURING PERIODS OF LAY UP OR DRY DOCK, WHILE THE VESSEL IS NOT IN SERVICE, OR FOR ANY OTHER REASON;

(16) FOR PURPOSES OF THE FORMULAS SET OUT IN (1) AND (12) OF THIS SUBSECTION, THE MARGINAL FEDERAL TAX RATE

(A) EXCEPT AS PROVIDED IN (B) OF THIS PARAGRAPH, IS THE HIGHEST MARGINAL FEDERAL CORPORATE INCOME TAX RATE FOR THE CALENDAR YEAR; IF THE FEDERAL INCOME TAX RATE CHANGES DURING THE YEAR, THE DEPARTMENT WILL APPLY THE NEW TAX RATE TO THAT PORTION FOR THE YEAR THAT EQUALS THE NUMBER OF DAYS IN THE YEAR THAT INCLUDE AND FOLLOW THE DAY ON WHICH THE OLD TAX RATE CHANGED, DIVIDED BY THE TOTAL NUMBER OF DAYS IN THAT YEAR; AND

(B) EQUALS 35 PERCENT, FOR A VESSEL FIRST PLACED IN SERVICE ON OR AFTER JANUARY 1, 1995 AND BEFORE JANUARY 1, 2002, FOR EACH YEAR BEFORE JANUARY 1, 2002;

(17) FOR PURPOSES OF THE FORMULAS SET OUT IN (2), (3), (5), (11), (13), AND (14) OF THIS SUBSECTION, WACC, OR THE WEIGHTED AVERAGE COST OF CAPITAL,

(A) EXCEPT AS PROVIDED IN (B) OF THIS PARAGRAPH, IS THE COST OF CAPITAL AS REASONABLY DETERMINED BY THE DEPARTMENT, FOR THE CATEGORY OF BUSINESS DESCRIBED FOR STANDARD INDUSTRIAL CLASSIFICATION (SIC) INDUSTRY NO. 4924, IN THE EXECUTIVE OFFICE OF THE PRESIDENT, OFFICE OF MANAGEMENT AND BUDGET,

STANDARD INDUSTRIAL CLASSIFICATION MANUAL, AS REVISED AS OF 1987; AS DESCRIBED IN THIS SUBPARAGRAPH, SIC INDUSTRY NO. 4924 IS ADOPTED BY REFERENCE; IN DETERMINING A COST OF CAPITAL FOR A CALENDAR YEAR UNDER THIS PARAGRAPH, THE DEPARTMENT WILL PRESUME, IN THE ABSENCE OF FACTS TO THE CONTRARY, THAT THE COST OF CAPITAL IS ACCURATELY REPRESENTED BY THE WEIGHTED AVERAGE COST OF CAPITAL USING THE CAPITAL ASSET PRICING MODEL (CAPM), ORDINARY LEAST SQUARES (OLS) FOR THE INDUSTRIAL COMPOSITE FOR SIC CODE NUMBER 4924, AS REPORTED IN DUFF & PHELPS, *VALUATION HANDBOOK, INDUSTRY COST OF CAPITAL* PUBLISHED DURING THE PREVIOUS CALENDAR YEAR, PLUS 0.4 PERCENT; AND

(B) IS EIGHT PERCENT, FOR A VESSEL FIRST PLACED IN SERVICE ON OR AFTER JANUARY 1, 1995 AND BEFORE JANUARY 1, 2002, FOR EACH YEAR BEFORE JANUARY 1, 2002;

(18) FOR PURPOSES OF THE FORMULAS SET OUT IN (3), (5), (9), AND (14) OF THIS SUBSECTION, FOR VESSELS THAT ARE FIRST PLACED IN SERVICE BY THE PRODUCER MID-YEAR, THE PORTION OF THE YEAR IN SERVICE FOR THE FIRST AND LAST CALENDAR YEARS THE VESSEL IS IN SERVICE IS THE NUMBER OF DAYS THE VESSEL IS IN SERVICE DURING THE YEAR DIVIDED BY 365, AND 100 PERCENT FOR ALL OTHER YEARS;

(19) VESSELS FIRST PLACED IN SERVICE BY THE PRODUCER ON OR AFTER JANUARY 1, 1995, THAT WERE IN SERVICE FOR A DIFFERENT PRODUCER OR FOR A DIFFERENT PERSON BEFORE THAT DATE AND SUBJECT TO (a) OF THIS

SECTION, CONTINUE TO BE SUBJECT TO (a) OF THIS SECTION, AND THE COST OF CAPITAL ALLOWANCE SET OUT IN THIS SUBSECTION WILL NOT BE ALLOWED FOR THOSE VESSELS; VESSELS FIRST PLACED IN SERVICE BY THE PRODUCER ON OR AFTER JANUARY 1, 1995, THAT WERE IN SERVICE FOR A DIFFERENT PERSON BEFORE THAT DATE AND SUBJECT TO (b) OF THIS SECTION, CONTINUE TO BE SUBJECT TO (b) OF THIS SECTION THROUGH DECEMBER 31, 2001; AFTER DECEMBER 31, 2001, THE COST OF CAPITAL ALLOWANCE SET OUT IN THIS SUBSECTION WILL BE ALLOWED FOR THOSE VESSELS;

(20) FOR PURPOSES OF (6), (9), AND (12) OF THIS SUBSECTION, IF THE TOTAL AMOUNT PAID TO THE PERSON SELLING THE VESSEL IS NOT BASED ON AN ARM'S-LENGTH, THIRD PARTY TRANSACTION, IS TIED TO THE RECEIPT OF OTHER CONSIDERATION, OR CANNOT REASONABLY BE ESTABLISHED BY THE TAXPAYER, THE TOTAL AMOUNT PAID TO THE PERSON SELLING THE VESSEL IS THE REMAINING UNRECOVERED INVESTMENT OF THE VESSEL AT THE TIME OF THE ACQUISITION AS DETERMINED BY THE DEPARTMENT; IN MAKING THIS DETERMINATION, THE DEPARTMENT WILL CONSIDER PRICES PAID FOR SIMILAR VESSELS AND OTHER FACTORS RELATED TO THE VALUE OF THE VESSEL;

(21) FOR PURPOSES OF THE FORMULA SET OUT IN (14) OF THIS SECTION, FOR VESSELS FIRST PLACED IN SERVICE BY THE PRODUCER ON OR AFTER JANUARY 1, 1995, THAT EITHER WERE IN SERVICE FOR A DIFFERENT PRODUCER OR FOR A DIFFERENT PERSON BEFORE JANUARY 1, 1995, OR WERE ENGAGED OUTSIDE THE STATE IN ORDINARY AND NECESSARY OPERATIONS INCURRED TO TRANSPORT OIL OR GAS BEFORE JANUARY 1, 1995, YEARS OF

REMAINING LIFE MUST BE DETERMINED AS IF THE VESSEL HAD A TOTAL 24-YEAR LIFE AND FOR A CAPITALIZED IMPROVEMENT THAT EXTENDS VESSEL LIFE AS IF THE CAPITALIZED IMPROVEMENT HAD A TOTAL 15-YEAR LIFE; THE LIVES OF THE VESSELS OR CAPITALIZED IMPROVEMENTS WILL BE CONSIDERED TO HAVE BEGUN AT THE FIRST LOADING OF OIL AND WILL NOT BE SUSPENDED DURING PERIODS OF LAY UP OR DRY DOCK, WHILE THE VESSEL IS NOT IN SERVICE, OR FOR ANY REASON;

(22) FOR PURPOSES OF (6), (9), AND (12) OF THIS SUBSECTION, IF A VESSEL IS ACQUIRED THROUGH A CONTRACT THAT STATES THE PURCHASE PRICE IN TERMS OF A FOREIGN CURRENCY, THE COST IS THE EQUIVALENT AMOUNT IN UNITED STATES DOLLARS AS DETERMINED BY APPLYING THE FOREIGN CURRENCY EXCHANGE RATE ON THE DATE THAT THE CONTRACT IS INITIALLY SIGNED; IF A MODIFICATION TO THE PURCHASE PRICE IS LATER MADE, THE FOREIGN CURRENCY EXCHANGE RATE ON THE DATE THAT THE MODIFICATION IS SIGNED MUST BE APPLIED TO THE AMOUNT BY WHICH THE PURCHASE PRICE IS CHANGED.

(g) THE FOLLOWING EXAMPLE ILLUSTRATES (f) OF THIS SECTION:

TAXPAYER A FIRST PLACES A VESSEL IN SERVICE IN YEAR ONE. THE TOTAL AMOUNT PAID TO THE PERSON BUILDING OR SELLING THE VESSEL IS $1,000,000. THE VESSEL COMES INTO SERVICE 75 PERCENT OF THE WAY INTO YEAR ONE; IT IS IN SERVICE 25 PERCENT OF THE YEAR. FOR THE FIRST PARTIAL CALENDAR YEAR OF CONSTRUCTION, THE TAX RATE IS 34 PERCENT AND THE WACC, INCLUDING THE ADDITIONAL 0.4 PERCENT DESCRIBED IN (f)(17)(A) OF

THIS SECTION, IS NINE PERCENT. FOR THE SECOND FULL CALENDAR YEAR OF CONSTRUCTION, THE TAX RATE IS 35 PERCENT AND THE WACC IS EIGHT PERCENT. FOR THE THIRD PARTIAL CALENDAR YEAR OF CONSTRUCTION, THE TAX RATE IS 36 PERCENT AND THE WACC IS SEVEN PERCENT. FOR THE FIRST YEAR OF SERVICE THE TAX RATE AND WACC ARE THE SAME AS FOR THE THIRD YEAR OF CONSTRUCTION. THE NET PRESENT VALUE OF THE CAPITAL CONSTRUCTION FUND BENEFIT IS $354,034.

THIS EXAMPLE SHOWS THE COST OF CAPITAL ALLOWANCE FOR A VESSEL CARRYING OIL.

STEP ONE: CALCULATE THE YEARLY OUTLAY FOR EACH CALENDAR YEAR OF CONSTRUCTION UNDER (f)(9)(A), (B), AND (C) OF THIS SECTION:

FOR THE PORTION OF THE FIRST YEAR CALENDAR YEAR OF CONSTRUCTION THE YEARLY OUTLAY WOULD BE:

0.25 * 0.5 * 1,000,000 = 125,000

FOR THE SECOND CALENDAR YEAR OF CONSTRUCTION THE YEARLY OUTLAY WOULD BE:

0.5 * 1,000,000 = 500,000

FOR THE PORTION OF THE THIRD CALENDAR YEAR OF CONSTRUCTION THE YEARLY OUTLAY WOULD BE:

(1 - 0.25) * 0.5 * 1,000,000 = 375,000

STEP TWO: CALCULATE THE CONSTRUCTION FINANCE FACTOR DURING CONSTRUCTION FOR EACH CALENDAR YEAR OF CONSTRUCTION UNDER (f)(11) OF THIS SECTION:

FOR THE PORTION OF THE FIRST CALENDAR YEAR OF CONSTRUCTION THE CONSTRUCTION FINANCE FACTOR DURING CONSTRUCTION WOULD BE:

((1 + 0.09) *exp*. (0.25 * 0.5)) * (1 + 0.08) * ((1 + 0.07) *exp*. (1 - 0.25)) = 1.148523540

FOR THE SECOND CALENDAR YEAR OF CONSTRUCTION THE CONSTRUCTION FINANCE FACTOR DURING CONSTRUCTION WOULD BE:

((1 + 0.08) *exp*. (0.5)) * ((1 + 0.07) *exp*. (1 - 0.25)) = 1.093326088

FOR THE PORTION OF THE THIRD CALENDAR YEAR OF CONSTRUCTION THE CONSTRUCTION FINANCE FACTOR DURING CONSTRUCTION WOULD BE:

(1 + 0.07) *exp*. ((1 - 0.25) * 0.5) = 1.025696602

STEP THREE: CALCULATE THE CONSTRUCTION UNRECOVERED INVESTMENT FOR EACH CALENDAR YEAR OF CONSTRUCTION UNDER (f)(10) OF THIS SECTION:

FOR THE FIRST CALENDAR YEAR OF CONSTRUCTION THE CONSTRUCTION UNRECOVERED INVESTMENT WOULD BE:

125,000 * 1.148523540 = 143,565

FOR THE SECOND CALENDAR YEAR OF CONSTRUCTION THE CONSTRUCTION UNRECOVERED INVESTMENT WOULD BE:

500,000 * 1.093326088 = 546,663

FOR THE THIRD CALENDAR YEAR OF CONSTRUCTION THE CONSTRUCTION UNRECOVERED INVESTMENT WOULD BE:

375,000 * 1.025696602 = 384,636

STEP FOUR: CALCULATE THE YEARLY CONSTRUCTION COST OF CAPITAL FOR EACH CALENDAR YEAR OF CONSTRUCTION UNDER (f)(8) OF THIS SECTION:

FOR THE FIRST YEAR OF CONSTRUCTION THE YEARLY CONSTRUCTION COST OF CAPITAL WOULD BE:

143,565 - 125,000 = 18,565

FOR THE SECOND YEAR OF CONSTRUCTION THE YEARLY CONSTRUCTION COST OF CAPITAL WOULD BE:

546,663 - 500,000 = 46,663

FOR THE THIRD YEAR OF CONSTRUCTION THE YEARLY CONSTRUCTION COST OF CAPITAL WOULD BE:

384,636 - 375,000 = 9,636

STEP FIVE: CALCULATE THE RETURN ON CAPITAL USED DURING CONSTRUCTION UNDER (f)(7) OF THIS SECTION:

18,565 + 46,663 + 9,636 = 74,865

STEP SIX: CALCULATE THE SALVAGE VALUE DISCOUNT FACTOR UNDER (f)(13) OF THIS SECTION:

(1/ ((1 + 0.07) *exp*. (24.5))) = 0.191

STEP SEVEN: CALCULATE THE AFTER-TAX NET PRESENT VALUE OF THE SALVAGE VALUE OF THE VESSEL IN YEAR 25 UNDER (f)(12) OF THIS SECTION:

0.04 * 1,000,000 * (1 - 0.36) * 0.191 = 4,879

STEP EIGHT: CALCULATE THE NET UNRECOVERED CAPITAL INVESTMENT UNDER (f)(6) OF THIS SECTION:

1,000,000 - 354,034 + 74,865 - 4,879 = 715,952

STEP NINE: CALCULATE THE PRESENT VALUE OF AN ORDINARY ANNUITY OF 1 AT THE END OF THE REMAINING LIFE UNDER (f)(14) OF THIS SECTION:

(((1 - (1 / ((1 + 0.07) *exp*. (24)))) / 0.07) / ((1 + 0.07) *exp*. (-0.5))) / 0.25 = 47.45589

STEP TEN: CALCULATE THE AFTER-TAX CASH FLOW UNDER (f)(2) OF THIS SECTION:

715,952 / 47.45589 = 15,087

STEP ELEVEN: CALCULATE THE COST OF CAPITAL ALLOWANCE UNDER (f)(1) OF THIS SECTION:

15,087 / (1 - 0.36) = 23,573

STEP TWELVE: CALCULATE THE MID-YEAR UNRECOVERED INVESTMENT UNDER (f)(5) OF THIS SECTION:

715,952 * ((1 + 0.07) *exp*. (0.25 * 0.5)) = 722,033

STEP THIRTEEN: CALCULATE THE REMAINING UNRECOVERED INVESTMENT UNDER (f)(3) OF THIS SECTION:

(722,033 - 15,087) * ((1 + 0.07) *exp*. (0.25 * 0.5)) = 712,951

TABLE 1 SHOWS THE COST OF CAPITAL ALLOWANCES FOR THE REMAINING YEARS USING THE TAX RATES AND WACCS GIVEN IN THE EXAMPLE.

TABLE 1

COST OF CAPITAL ALLOWANCE FOR VESSELS CARRYING OIL

TABLE 1
COST OF CAPITAL ALLOWANCE FOR VESSELS CARRYING OIL OR COMMINGLED OIL AND NGLS

Year	Portion of Year in Service	Marginal Federal Tax Rate	Weighted Average Cost Of Capital	Remaining Years	Present Value Annuity	After-Tax Cash Flow	Cost of Capital Allowance	Unrecovered Investment Mid-Year	Unrecovered Investment End of Year
1	25%	0.36	0.07	24.00	47.45589	15,087	23,573	722,033	712,951
2	100%	0.37	0.06	23.75	12.85920	55,443	88,005	734,028	698,646
3	100%	0.38	0.05	22.75	13.73979	50,848	82,013	715,899	681,474
4	100%	0.39	0.06	21.75	12.32769	55,280	90,623	701,620	665,448
5	100%	0.40	0.07	20.75	11.14748	59,695	99,492	688,345	650,281
6	100%	0.41	0.08	19.75	10.14918	64,072	108,597	675,792	635,717
7	100%	0.42	0.09	18.75	9.29506	68,393	117,919	663,708	621,527
8	100%	0.43	0.10	17.75	8.55623	72,640	127,439	651,864	607,494
9	100%	0.44	0.11	16.75	7.91020	76,799	137,141	640,035	593,406
10	100%	0.45	0.12	15.75	7.33923	80,854	147,007	628,002	579,047
11	100%	0.44	0.13	14.75	6.82904	84,792	151,414	615,535	564,188
12	100%	0.43	0.14	13.75	6.36790	88,599	155,436	602,388	548,577
13	100%	0.42	0.15	12.75	5.94594	92,261	159,070	588,293	531,925
14	100%	0.41	0.14	11.75	5.99083	88,790	150,491	567,940	511,593
15	100%	0.40	0.13	10.75	5.97916	85,563	142,604	543,830	487,145
16	100%	0.39	0.12	9.75	5.89803	82,595	135,401	515,546	458,193
17	100%	0.38	0.11	8.75	5.73467	79,899	128,869	482,736	424,416
18	100%	0.37	0.10	7.75	5.47734	77,486	122,993	445,131	385,589
19	100%	0.36	0.09	6.75	5.11636	75,486	117,756	402,567	341,610
20	100%	0.35	0.08	5.75	4.64521	73,540	113,139	355,012	292,514
21	100%	0.34	0.07	4.75	4.06155	72,020	109,122	302,578	238,491
22	100%	0.33	0.06	3.75	3.36810	70,809	105,685	245,542	179,899
23	100%	0.32	0.05	2.75	2.57324	69,911	102,811	184,341	117,256
24	100%	0.31	0.06	1.75	1.66350	70,487	102,156	120,722	51,720
25	75%	0.30	0.07	0.75	0.97487	53,053	75,790	53,049	–5

(h) FOR AN IMPROVEMENT TO A VESSEL THAT DOES NOT EXTEND THE LIFE OF A VESSEL AND THAT WAS FIRST PLACED IN SERVICE ON OR AFTER JANUARY 1, 1995, A COST OF CAPITAL ALLOWANCE THAT CONSISTS OF DEPRECIATION AND A RETURN ON INVESTMENT WILL BE ALLOWED FOR OIL OR GAS PRODUCED DURING CALENDAR YEAR 2002, EXCEPT THAT A PRODUCER MAY ELECT TO EXPENSE THE FIRST $1,000,000 IN COSTS INCURRED WITH RESPECT TO IMPROVEMENTS DURING CALENDAR YEAR 2002. AN AMOUNT EXPENSED MAY BE EITHER DEDUCTED IN THE MONTH INCURRED OR AMORTIZED OVER ALL MONTHS IN CALENDAR YEAR 2002. AN IMPROVEMENT

THAT THE PRODUCER TREATS AS AN EXPENSE UNDER 26 U.S.C. 179 MAY NOT RECEIVE A COST OF CAPITAL ALLOWANCE UNDER THIS SUBSECTION. THE COST OF CAPITAL ALLOWANCE UNDER THIS SUBSECTION IS AN AMOUNT TO BE CALCULATED ANNUALLY FOR A CALENDAR YEAR AS FOLLOWS:

(1) THE COST OF CAPITAL ALLOWANCE IS CALCULATED USING THE FOLLOWING FORMULA: COST OF CAPITAL ALLOWANCE = INITIAL CASH FLOW / (1 - MARGINAL FEDERAL TAX RATE);

(2) FOR PURPOSES OF THE FORMULA SET OUT IN (1) OF THIS SUBSECTION, INITIAL CASH FLOW IS CALCULATED USING THE FOLLOWING FORMULA: INITIAL CASH FLOW = (REMAINING UNRECOVERED INVESTMENT FROM THE PRIOR YEAR - AFTER-TAX PRESENT VALUE OF FUTURE TAX DEPRECIATION BENEFITS) / PRESENT VALUE OF AN ORDINARY ANNUITY OF 1 AT THE END OF n PERIODS, WHERE "n" IS YEARS OF REMAINING LIFE AT INTEREST RATE WACC;

(3) FOR PURPOSES OF THE FORMULA SET OUT IN (2) OF THIS SUBSECTION, REMAINING UNRECOVERED INVESTMENT IS CALCULATED USING THE FOLLOWING FORMULA: REMAINING UNRECOVERED INVESTMENT = (FINANCE COST - TOTAL AFTER-TAX CASH FLOW) * ((1 + WACC) *exp*. (PORTION OF YEAR IN SERVICE * 0.5));

(4) FOR PURPOSES OF THE FORMULA SET OUT IN (3) OF THIS SUBSECTION, FINANCE COST IS CALCULATED USING THE FOLLOWING FORMULA: FINANCE COST = REMAINING UNRECOVERED INVESTMENT FROM THE PRIOR YEAR * ((1 + WACC) *exp*. (PORTION OF YEAR IN SERVICE * 0.5));

(5) FOR PURPOSES OF THE FORMULA SET OUT IN (4) OF THIS SUBSECTION, REMAINING UNRECOVERED INVESTMENT FROM THE PRIOR YEAR FOR THE FIRST YEAR THE CAPITALIZED IMPROVEMENT TO A VESSEL IS IN SERVICE IS THE TOTAL AMOUNT PAID TO THE PERSON BUILDING OR SELLING THE CAPITALIZED IMPROVEMENT TO THE PRODUCER;

(6) FOR PURPOSES OF THE FORMULA SET OUT IN (3) OF THIS SUBSECTION, TOTAL AFTER-TAX CASH FLOW IS CALCULATED USING THE FOLLOWING FORMULA: TOTAL AFTER-TAX CASH FLOW = INITIAL CASH FLOW + AFTER-TAX CASH FLOW OF DEPRECIATION BENEFITS FOR THAT TAX YEAR;

(7) FOR PURPOSES OF THE FORMULA SET OUT IN (6) OF THIS SUBSECTION, AFTER-TAX CASH FLOW OF DEPRECIATION BENEFITS FOR THAT TAX YEAR IS CALCULATED USING THE FOLLOWING FORMULA: AFTER-TAX CASH FLOW OF DEPRECIATION BENEFITS FOR THAT TAX YEAR = TOTAL AMOUNT PAID TO THE PERSON BUILDING OR SELLING THE CAPITALIZED IMPROVEMENT TO A VESSEL TO THE PRODUCER * MARGINAL FEDERAL TAX RATE * FEDERAL DEPRECIATION FACTOR;

(8) FOR PURPOSES OF THE FORMULAS SET OUT IN (7) AND (11) OF THIS SUBSECTION, THE FEDERAL DEPRECIATION FACTOR

(A) EXCEPT AS PROVIDED IN (B) OF THIS PARAGRAPH, IS THE PERCENTAGE OF THE TOTAL AMOUNT PAID TO THE PERSON BUILDING OR SELLING THE CAPITALIZED IMPROVEMENT BY THE PRODUCER THAT CAN BE DEPRECIATED FOR FEDERAL CORPORATE INCOME TAX FOR THE TAX YEAR; AND

(B) FOR A CAPITALIZED IMPROVEMENT THAT DOES NOT EXTEND THE LIFE OF A VESSEL AND THAT WAS FIRST PLACED IN SERVICE ON OR AFTER JANUARY 1, 1995 AND BEFORE JANUARY 1, 2002, FOR EACH YEAR BEFORE JANUARY 1, 2002, IS THE PERCENTAGE ALLOWED ON A FIVE-YEAR SCHEDULE AS FOLLOWS:

(i) FOR YEAR ONE, 15 PERCENT;

(ii) FOR YEAR TWO, 22 PERCENT;

(iii) FOR YEAR THREE, 21 PERCENT;

(iv) FOR YEAR FOUR, 21 PERCENT;

(v) FOR YEAR FIVE, 21 PERCENT;

(9) FOR PURPOSES OF (2) OF THIS SUBSECTION, AFTER-TAX PRESENT VALUE OF FUTURE TAX DEPRECIATION BENEFITS IS THE SUM OF THE DISCOUNTED ANNUAL TAX DEPRECIATION AMOUNTS FOR EACH REMAINING YEAR IN WHICH THE TOTAL AMOUNT PAID TO THE PERSON BUILDING OR SELLING THE PIPELINE FACILITY TO THE PRODUCER CAN BE DEPRECIATED FOR FEDERAL CORPORATE INCOME TAX FOR THE TAX YEAR;

(10) FOR PURPOSES OF (9) OF THIS SUBSECTION, A DISCOUNTED ANNUAL TAX DEPRECIATION AMOUNT IS CALCULATED USING THE FOLLOWING FORMULA: DISCOUNTED ANNUAL TAX DEPRECIATION AMOUNT = FEDERAL DEPRECIATION FACTOR * TOTAL AMOUNT PAID TO THE PERSON BUILDING OR SELLING THE CAPITALIZED IMPROVEMENT TO A VESSEL TO THE PRODUCER * MARGINAL FEDERAL TAX RATE * DISCOUNT FACTOR;

(11) FOR PURPOSES OF THE FORMULAS SET OUT IN (1), (7), AND (10) OF THIS SUBSECTION, MARGINAL FEDERAL TAX RATE

(A) EXCEPT AS PROVIDED IN (B) OF THIS PARAGRAPH, IS THE HIGHEST MARGINAL FEDERAL CORPORATE INCOME TAX RATE FOR THE CALENDAR YEAR; IF THE FEDERAL INCOME TAX RATE CHANGES DURING THE YEAR, THE DEPARTMENT WILL APPLY THE NEW TAX RATE TO THAT PORTION FOR THE YEAR THAT EQUALS THE NUMBER OF DAYS IN THE YEAR THAT INCLUDE AND FOLLOW THE DAY ON WHICH THE OLD TAX RATE CHANGED, DIVIDED BY THE TOTAL NUMBER OF DAYS IN THAT YEAR; AND

(B) EQUALS 37 PERCENT, FOR A CAPITALIZED IMPROVEMENT THAT DOES NOT EXTEND THE LIFE OF A VESSEL AND THAT WAS FIRST PLACED IN SERVICE ON OR AFTER JANUARY 1, 1995 AND BEFORE JANUARY 1, 2002, FOR EACH YEAR BEFORE JANUARY 1, 2002;

(12) FOR PURPOSES OF THE FORMULA SET OUT IN (10) OF THIS SUBSECTION, DISCOUNT FACTOR IS CALCULATED USING THE FOLLOWING FORMULA: DISCOUNT FACTOR = 1 / ((1 + WACC) *exp*. (DISCOUNT FACTOR EXPONENT));

(13) FOR PURPOSES OF THE FORMULA SET OUT IN (12) OF THIS SUBSECTION, THE DISCOUNT FACTOR EXPONENT IS CALCULATED USING THE FOLLOWING FORMULA: DISCOUNT FACTOR EXPONENT = (((((1 - PORTION OF YEAR IN SERVICE) + 1) * 0.5) - 1) + YEAR DEPRECIATION BENEFIT IS REALIZED);

(14) FOR PURPOSES OF THE FORMULA SET OUT IN (2) OF THIS SUBSECTION, THE PRESENT VALUE OF AN ORDINARY ANNUITY OF 1 AT THE END OF n PERIODS, WHERE "n" IS YEARS OF REMAINING LIFE AT INTEREST RATE WACC, IS CALCULATED USING THE FOLLOWING FORMULA: PRESENT VALUE OF AN ORDINARY ANNUITY OF 1 AT THE END OF n PERIODS = (((1 - (1/ ((1 + WACC) *exp*. (YEARS OF REMAINING LIFE)))) / WACC) / ((1 + WACC) *exp*. (-0.5))) / PORTION OF YEAR IN SERVICE;

(15) FOR PURPOSES OF THE FORMULA SET OUT IN (14) OF THIS SUBSECTION, YEARS OF REMAINING LIFE MUST BE DETERMINED FOR EACH CAPITALIZED IMPROVEMENT TO A VESSEL AS IF IT HAD A 10-YEAR LIFE BEGINNING ON THE FIRST DAY OF THE MONTH THAT THE VESSEL WITH THE NEW IMPROVEMENT TAKES ON A LOAD OF OIL; THE LIFE OF THE CAPITALIZED IMPROVEMENT WILL NOT BE SUSPENDED DURING PERIODS OF LAY UP OR DRY DOCK, WHILE THE VESSEL IS NOT IN SERVICE, OR FOR ANY OTHER REASON;

(16) FOR PURPOSES OF THE FORMULAS SET OUT IN (2), (3), (4), (12), AND (14) OF THIS SUBSECTION, WACC, OR THE WEIGHTED AVERAGE COST OF CAPITAL,

(A) EXCEPT AS PROVIDED IN (B) OF THIS PARAGRAPH, IS THE COST OF CAPITAL AS REASONABLY DETERMINED BY THE DEPARTMENT, FOR THE CATEGORY OF BUSINESS DESCRIBED FOR STANDARD INDUSTRIAL CLASSIFICATION (SIC) INDUSTRY NO. 4924, IN THE EXECUTIVE OFFICE OF THE PRESIDENT, OFFICE OF MANAGEMENT AND BUDGET, *STANDARD INDUSTRIAL CLASSIFICATION MANUAL*, AS REVISED AS OF 1987;

AS DESCRIBED IN THIS SUBPARAGRAPH, SIC INDUSTRY NO. 4924 IS ADOPTED BY REFERENCE; IN DETERMINING A COST OF CAPITAL FOR A CALENDAR YEAR UNDER THIS PARAGRAPH, THE DEPARTMENT WILL PRESUME, IN THE ABSENCE OF FACTS TO THE CONTRARY, THAT THE COST OF CAPITAL IS ACCURATELY REPRESENTED BY THE WEIGHTED AVERAGE COST OF CAPITAL USING THE CAPITAL ASSET PRICING MODEL (CAPM), ORDINARY LEAST SQUARES (OLS) FOR THE INDUSTRIAL COMPOSITE FOR SIC CODE NUMBER 4924, AS REPORTED IN DUFF & PHELPS *VALUATION HANDBOOK, INDUSTRY COST OF CAPITAL* PUBLISHED DURING THE PREVIOUS CALENDAR YEAR, PLUS 0.4 PERCENT; AND

(B) IS EIGHT PERCENT, FOR A CAPITALIZED IMPROVEMENT THAT DOES NOT EXTEND THE LIFE OF A VESSEL AND THAT WAS FIRST PLACED IN SERVICE ON OR AFTER JANUARY 1, 1995 AND BEFORE JANUARY 1, 2002, FOR EACH YEAR BEFORE JANUARY 1, 2002;

(17) FOR PURPOSES OF THE FORMULA SET OUT IN (3), (4), (13), AND (14) OF THIS SUBSECTION, FOR CAPITALIZED IMPROVEMENTS TO A VESSEL THAT COME INTO SERVICE MID-YEAR, THE PORTION OF THE YEAR IN SERVICE FOR THE FIRST AND LAST CALENDAR YEARS THE CAPITALIZED IMPROVEMENT TO A VESSEL IS IN SERVICE IS THE NUMBER OF DAYS THE CAPITALIZED IMPROVEMENT TO A VESSEL IS IN SERVICE DURING THE YEAR DIVIDED BY 365, AND 100 PERCENT FOR ALL OTHER YEARS;

(18) CAPITALIZED IMPROVEMENTS TO A VESSEL ACQUIRED FOR SERVICE ON OR AFTER JANUARY 1, 1995, THAT WERE IN SERVICE BEFORE THAT

DATE AND SUBJECT TO (a) OF THIS SECTION, CONTINUE TO BE SUBJECT TO (a) OF THIS SECTION, AND THE COST OF CAPITAL ALLOWANCE SET OUT IN THIS SUBSECTION WILL NOT BE ALLOWED FOR THOSE CAPITALIZED IMPROVEMENTS; CAPITALIZED IMPROVEMENTS TO A VESSEL ACQUIRED FOR SERVICE ON OR AFTER JANUARY 1, 1995, THAT WERE IN SERVICE BEFORE THAT DATE AND SUBJECT TO (b) OF THIS SECTION CONTINUE TO BE SUBJECT TO (b) OF THIS SECTION THROUGH DECEMBER 31, 2001; AFTER DECEMBER 31, 2001, THE COST OF CAPITAL ALLOWANCE SET OUT IN THIS SUBSECTION WILL BE ALLOWED FOR THOSE CAPITALIZED IMPROVEMENTS;

(19) FOR PURPOSES OF (5), (7), AND (10) OF THIS SUBSECTION, IF THE TOTAL AMOUNT PAID TO THE PERSON SELLING THE CAPITALIZED IMPROVEMENT TO A VESSEL IS NOT BASED ON AN ARM'S-LENGTH, THIRD PARTY TRANSACTION, IS TIED TO THE RECEIPT OF OTHER CONSIDERATION, OR CANNOT REASONABLY BE ESTABLISHED BY THE TAXPAYER, THE TOTAL AMOUNT PAID TO THE PERSON SELLING THE CAPITALIZED IMPROVEMENT TO A VESSEL WILL BE DETERMINED BY THE DEPARTMENT; IN MAKING THIS DETERMINATION, THE DEPARTMENT WILL CONSIDER PRICES PAID FOR SIMILAR IMPROVEMENTS AND OTHER FACTORS RELATED TO THE VALUE OF THE CAPITALIZED IMPROVEMENT;

(20) FOR PURPOSES OF (5), (7), AND (10) OF THIS SUBSECTION, IF A CAPITALIZED IMPROVEMENT TO A VESSEL IS ACQUIRED THROUGH A CONTRACT THAT STATES THE PURCHASE PRICE IN TERMS OF A FOREIGN CURRENCY, THE COST IS THE EQUIVALENT AMOUNT IN UNITED STATES DOLLARS AS DETERMINED BY APPLYING THE FOREIGN CURRENCY EXCHANGE RATE ON THE

DATE THAT THE CONTRACT IS INITIALLY SIGNED; IF A MODIFICATION TO THE PURCHASE PRICE IS LATER MADE, THE FOREIGN CURRENCY EXCHANGE RATE ON THE DATE THAT THE MODIFICATION IS SIGNED MUST BE APPLIED TO THE AMOUNT BY WHICH THE PURCHASE PRICE IS CHANGED.

(i) THE FOLLOWING EXAMPLE ILLUSTRATES (h) OF THIS SECTION:

TAXPAYER A PLACES A CAPITALIZED IMPROVEMENT TO A VESSEL INTO SERVICE IN YEAR ONE. THE TOTAL AMOUNT PAID TO THE PERSON BUILDING OR SELLING THE IMPROVEMENT IS $1,000,000. THE IMPROVEMENT COMES INTO SERVICE 75 PERCENT OF THE WAY INTO YEAR ONE; IT IS IN SERVICE 25 PERCENT OF THE YEAR. FOR THE FIRST YEAR OF SERVICE THE TAX RATE IS 37 PERCENT AND THE WACC, INCLUDING THE ADDITIONAL 0.4 PERCENT DESCRIBED IN (h)(16) OF THIS SECTION, IS SIX PERCENT. THE FEDERAL DEPRECIATION FACTORS ARE AS FOLLOWS:

YEAR 1 = 15%

YEAR 2 = 22%

YEAR 3 = 21%

YEAR 4 = 21%

YEAR 5 = 21%

BECAUSE THE IMPROVEMENT BEGINS SERVICE MID-YEAR, THE FEDERAL DEPRECIATION FACTORS ARE WEIGHTED FOR TIME IN SERVICE AS FOLLOWS:

YEAR 1 = (0.25 * 15%) = 0.0375

YEAR 2 = (0.75 * 15%) + (0.25 * 22%) = 0.1675

YEAR 3 = (0.75 * 22%) + (0.25 * 21%) = 0.2175

YEAR 4 = (0.75 * 21%) + (0.25 * 21%) = 0.2100

YEAR 5 = (0.75 * 21%) + (0.25 * 21%) = 0.2100

YEAR 6 = (0.75 * 21%) = 0.1575

THIS EXAMPLE SHOWS THE COST OF CAPITAL ALLOWANCE FOR AN IMPROVEMENT TO A VESSEL CARRYING OIL.

STEP ONE: CALCULATE THE DISCOUNT FACTOR EXPONENT FOR YEAR ONE UNDER (h)(13) OF THIS SECTION:

(((((1 - 0.25) + 1) * 0.5) - 1) + 1) = 0.875

STEP TWO: CALCULATE THE DISCOUNT FACTOR FOR YEAR ONE UNDER (h)(12) OF THIS SECTION:

1 / ((1 + 0.06) *exp*. (0.875)) = 0.950

STEP THREE: CALCULATE THE DISCOUNTED ANNUAL TAX DEPRECIATION AMOUNT FOR YEAR ONE UNDER (h)(10) OF THIS SECTION:

0.0375 * 1,000,000 * 0.37 * 0.950 = 13,185

STEP FOUR: CALCULATE THE AFTER-TAX PRESENT VALUE OF FUTURE TAX DEPRECIATION BENEFITS FOR YEAR ONE UNDER (h)(9) OF THIS SECTION BY ADDING THE DISCOUNTED TAX DEPRECIATION AMOUNTS FOR THE FIRST FIVE COMPLETE YEARS:

YEAR 1 = 0.0375 * 1,000,000 * 0.37 * 0.950 = 13,185

YEAR 2 = 0.1675 * 1,000,000 * 0.37 * 0.916 = 56,788

YEAR 3 = 0.2175 * 1,000,000 * 0.37 * 0.864 = 69,566

YEAR 4 = 0.2100 * 1,000,000 * 0.37 * 0.816 = 63,365

YEAR 5 = 0.2100 * 1,000,000 * 0.37 * 0.769 = 59,788

YEAR 6 = 0.1575 * 1,000,000 * 0.37 * 0.726 = 42,296

TOTAL 304,979.

TABLE 1 SHOWS THE DERIVATION OF THE AFTER-TAX PRESENT VALUE OF FUTURE TAX DEPRECIATION BENEFITS FOR YEARS ONE - SIX.

STEP FIVE: CALCULATE THE FINANCE COST FOR YEAR ONE UNDER (h)(4) OF THIS SECTION:

1,000,000 * ((1 + 0.06) *exp*. (0.25 * 0.5)) = 1,007,310

STEP SIX: CALCULATE THE PRESENT VALUE OF AN ORDINARY ANNUITY OF 1 FOR YEAR ONE UNDER (h)(14) OF THIS SECTION:

(((1 - (1 / ((1 + 0.06) *exp*. (10)))) / 0.06) / ((1 + 0.06) *exp*. (-0.5)))/ 0.25 = 30.31069

STEP SEVEN: CALCULATE THE INITIAL CASH FLOW UNDER (h)(2) OF THIS SECTION:

(1,000,000 - 304,979)/ 30.31069 = 22,930

STEP EIGHT: CALCULATE THE COST OF CAPITAL ALLOWANCE UNDER (h)(1) OF THIS SECTION:

22,930 / (1 - 0.37) = 36,397

STEP NINE: CALCULATE THE AFTER-TAX CASH FLOW OF DEPRECIATION BENEFITS FOR YEAR ONE UNDER (h)(7) OF THIS SECTION:

1,000,000 * 0.37 * 0.0375 = 13,875

STEP TEN: CALCULATE THE TOTAL AFTER-TAX CASH FLOW FOR YEAR ONE UNDER (h)(6) OF THIS SECTION:

22,930 + 13,875 = 36,805

STEP ELEVEN: CALCULATE THE REMAINING UNRECOVERED INVESTMENT AT THE END OF YEAR ONE UNDER (H)(3) OF THIS SECTION:

(1,007,310 - 36,805) * ((1 + .06) *exp*. (0.25 * 0.5)) = 977,600

TABLE 2 SHOWS THE CAPITAL CONSTRUCTION ALLOWANCES FOR THE REMAINING YEARS USING THE TAX RATES AND WACCS GIVEN IN THE EXAMPLE.

TABLE 1: AFTER-TAX PRESENT VALUE OF FUTURE DEPRECIATION BENEFITS

TABLE 1: AFTER-TAX PRESENT VALUE OF FUTURE DEPRECIATION BENEFITS

	Unadjusted Federal Depreciation Factor	Depreciation Factor Adjusted for Partial Year Start-Up	Year Depreciation Benefit Realized	Discount Factor Exponent	Discount Factor	Present Value Annual Tax Depreciation Amount
Year 1	0	0.0375	1	0.875	0.950	13,185
	0.15	0.1675	2	1.500	0.916	56,788
	0.22	0.2175	3	2.500	0.864	69,566
	0.21	0.2100	4	3.500	0.816	63,365
	0.21	0.2100	5	4.500	0.769	59,778
	0.21	0.1575	6	5.500	0.726	42,296
					total	304,979
Year 2	0.22	0.1675	1	0.500	0.976	62,116
	0.21	0.2175	2	1.500	0.929	76,817
	0.21	0.2100	3	2.500	0.885	70,637
	0.21	0.2100	4	3.500	0.843	67,273
	0	0.1575	5	4.500	0.803	48,052
					total	324,895
Year 3	0.21	0.2175	1	0.500	0.971	82,389
	0.21	0.2100	2	1.500	0.916	75,046
	0.21	0.2100	3	2.500	0.864	70,798
	0	0.1575	4	3.500	0.816	50,093
					total	278,325
Year 4	0.21	0.2100	1	0.500	0.967	81,206
	0.21	0.2100	2	1.500	0.903	75,893
	0	0.1575	3	2.500	0.844	53,196
					total	210,295
Year 5	0.21	0.2100	1	0.500	0.962	82,850
	0	0.1575	2	1.500	0.891	57,535
					total	140,384
Year 6	0	0.1575	1	0.500	0.958	63,360
					total	63,360

TABLE 2: COST OF CAPITAL ALLOWANCE FOR IMPROVEMENTS TO VESSELS CARRYING OIL

TABLE 2: COST OF CAPITAL ALLOWANCE FOR IMPROVEMENTS TO VESSELS CARRYING OIL (cont.)

TABLE 2: COST OF CAPITAL ALLOWANCE FOR IMPROVEMENTS TO VESSELS CARRYING OIL OR COMMINGLED OIL AND NGLS

Year	Portion of Year in Service	Tax Rate	Weighted Average Cost Of Capital	Remaining Years	After-Tax Present Value (ATPV) of Future Tax Depreciation	Finance Cost	Finance Cost Minus Total After-Tax Cash Flow
1	25%	0.37	0.06	10.00	304,979	1,007,310	970,505
2	100%	0.38	0.05	9.75	324,895	1,001,742	853,959
3	100%	0.39	0.06	8.75	278,325	900,917	729,026
4	100%	0.40	0.07	7.75	210,295	776,404	602,806
5	100%	0.41	0.08	6.75	140,384	648,009	470,112
6	100%	0.42	0.09	5.75	63,360	510,066	350,112
7	100%	0.43	0.10	4.75	0	383,369	287,650
8	100%	0.44	0.11	3.75	0	317,850	220,589
9	100%	0.45	0.12	2.75	0	245,954	147,539
10	100%	0.44	0.13	1.75	0	165,980	66,813
11	75%	0.43	0.14	0.75	0	74,600	−23

TABLE 2: COST OF CAPITAL ALLOWANCE FOR IMPROVEMENTS TO VESSELS CARRYING OIL OR COMMINGLED OIL AND NGLS (cont.)

Year	Remaining Unrecovered Investment	Unrecovered Investment minus ATPV Future Tax Depreciation	Present Value Annuity	Initial Cash Flow	After-Tax Cash Flow Depreciation Benefits	Total After-Tax Cash Flow (TATCF)	Cost of Capital Allowance
1	977,600	695,021	30.31069	22,930	13,875	36,805	36,397
2	875,047	652,705	7.75802	84,133	63,650	147,783	135,698
3	750,578	596,722	6.85373	87,065	84,825	171,890	142,730
4	623,547	540,283	6.03005	89,598	84,000	173,598	149,331
5	488,555	483,163	5.26337	91,797	86,100	177,897	155,589
6	365,528	425,195	4.53280	93,804	66,150	159,954	161,731
7	301,690	365,528	3.81878	95,719	0	95,719	167,927
8	232,405	301,690	3.10186	97,261	0	97,261	173,681
9	156,140	232,405	2.36147	98,416	0	98,416	178,937
10	71,024	156,140	1.57453	99,166	0	99,166	177,082
11	−25	71,024	0.95175	74,624	0	74,624	130,919

(Eff. 1/1/2000, Register 152; am 1/1/2002, Register 160; am 1/1/2003, Register 164; am 5/3/2007, Register 182; am 4/30/2010, Register 194; am 3/1/2017, Register 221; repealed _____/_____/_____, Register _____)

Authority: AS 43.05.080 AS 43.55.030 AS 43.55.110
AS 43.55.020 AS 43.55.040 AS 43.55.150

15 AAC 55.196(a) is amended to read:

15 AAC 55.196. Cost of capital allowance to be used in calculation of costs of vessel transportation for oil or gas [PRODUCED ON OR AFTER JANUARY 1, 2003, OTHER THAN CERTAIN COSTS PERTAINING TO VESSELS PLACED IN SERVICE BEFORE JANUARY 1, 1995], and in calculation of transportation costs for gas by an LNG transportation facility [PLACED IN SERVICE AFTER DECEMBER 31, 2010]. (a) **For** [EXCEPT IF 15 AAC 55.195(A) APPLIES, FOR] oil or gas produced on or after January 1, 2003, a cost of capital allowance that consists of depreciation and a return on invested capital will be allowed under this section, as provided in **15 AAC 55.193** [15 AAC 55.191 OR 15 AAC 55.193, AS APPLICABLE,] for a (1) vessel, or an improvement completed on or after January 1, 2002 to a vessel, owned or effectively owned by the producer; or (2) LNG transportation facility owned or effectively owned by the producer and placed in service after December 31, 2010, or an improvement to that facility. However, a producer may elect to expense the first [$1,000,000] **$2,000,000** in costs incurred with respect to improvements during a calendar year.

15 AAC 55.196(d) is amended to read:

(d) **A**[WITH THE EXCEPTIONS SET OUT IN THIS SUBSECTION FOR AN LNG TRANSPORTATION FACILITY, A] cost of capital allowance under this section must be calculated using the methodology set out in the department's publication *Computation of a Cost-of-Capital Allowance under 15 AAC 55.196, Incorporating Depreciation and Return on Invested Capital for Marine Vessels and Improvements*, [THIRD] Edition **4.0**, dated **INSERT DATE** [SEPTEMBER 19, 2018] and adopted by reference. [IN THE CASE OF AN LNG TRANSPORTATION FACILITY,

(1) THE METHODOLOGY IS APPLIED AS IF THE TERM "VESSEL" READ "LNG TRANSPORTATION FACILITY";

(2) THE USEFUL LIFE FOR PURPOSES OF THE METHODOLOGY IS 30 YEARS;

(3) THE WEIGHTED AVERAGE COST OF CAPITAL IS 0.2 PERCENTAGE POINT GREATER THAN THAT OTHERWISE CALCULATED UNDER THE METHODOLOGY.]

15 AAC 55.800(e)(4) is repealed:

(4) repealed ____/_____/_____[15 AAC 55.191(b)(8)];

15 AAC 55.800(e)(5) is repealed:

(5) repealed ____/_____/_____[15 AAC 55.195(g) AND (i)];

15 AAC 55.800(g) is repealed:

(g) repealed _____/_____/_____[THE PROVISIONS OF 15 AAC 55.805 APPLY RETROACTIVELY TO JULY 1, 2007, INSOFAR AS THAT SECTION AFFECTS THE DETERMINATION OF TAX FOR PERIODS AFTER JUNE 30, 2007, AND OTHERWISE APPLY RETROACTIVELY TO JANUARY 1, 2007].

15 AAC 55.800(j)(4) is repealed:

(4) repealed _____/_____/_____[15 AAC 55.195(a)]

15 AAC 55.800(j)(5) is repealed:

(5) repealed _____/_____/_____[15 AAC 55.195(c)(1)].

(Eff. 5/3/2007, Register 182; am 10/21/2009, Register 192; am 2/2/7/2010, Register 193; am 4/30/2010, Register 194; am 12/4/2010, Register 196; am 3/1/2017, Register 221; am 1/1/2018, Register 224; am _____/_____/_____, Register _____)

Authority: AS 43.05.080 Sec. 72, ch. 1, SSSLA 2007 Sec. 41, ch. 3, SSLA 2017
AS 43.55.110 Sec. 38, ch. 4, 4SSLA 2016 Sec. 42, ch. 3, SSLA 2017
Sec. 37, ch. 2, TSSLA 2006